AIR1CA CAREER INSTITUTE

CA FINAL

PAPER 7 : DIRECT TAX LAWS AND INTERNATIONAL TAXATION

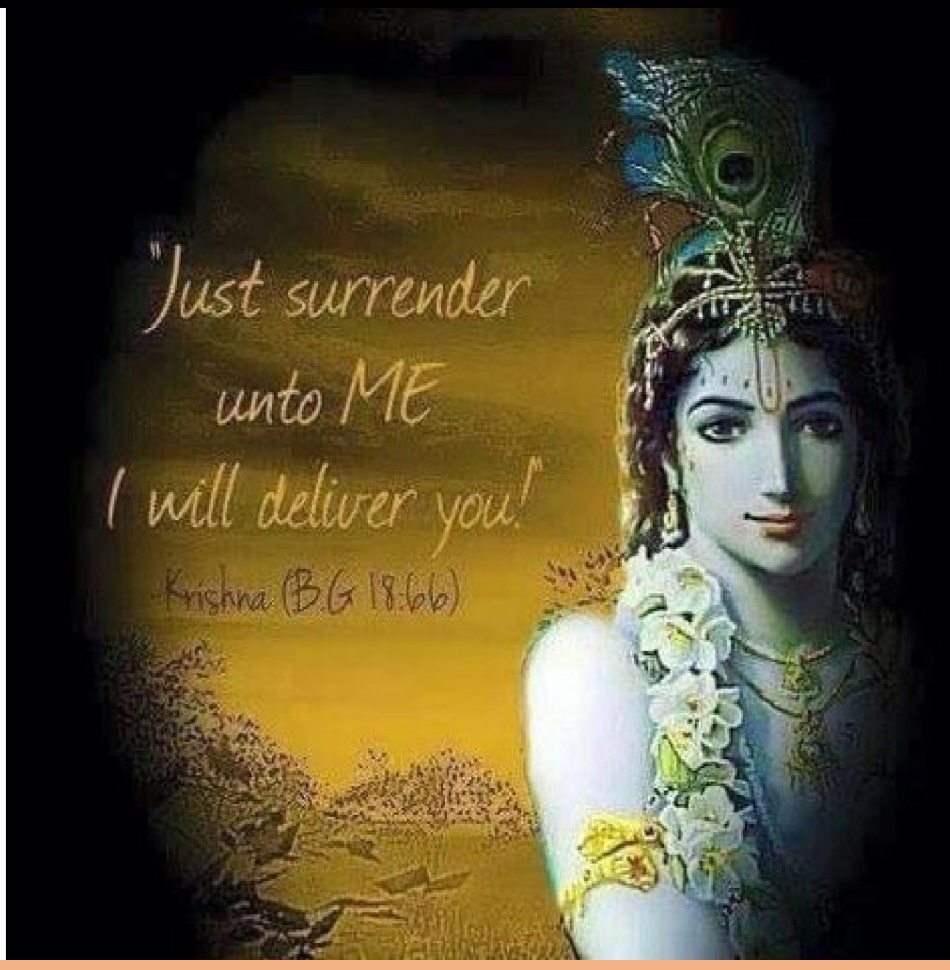
QUESTION BANK

As amended by the Finance (No. 2) Act, 2019
[Assessment Year 2020-21]

(Relevant for **JULY 2020 & NOV 2020** examination)

It covers:

- ✓ All ICAI Study Material Illustration & Exercise Questions
- ✓ All RTP Questions (upto May 20)
- ✓ All MTP Questions (upto May 20)
- ✓ All Past Exam (Old & New Course) Questions (upto Nov 19)
- ✓ All Relevant Questions from Old Course PM



This Question Bank has been prepared by **CA ATUL AGARWAL (AIR-1)**. It contains **around 500 Questions** which are divided in 2 Sections in each chapter. **SECTION-A** contains ICAI Study Material Questions and **SECTION-B** contains Additional Questions (covering Past RTPs, MTPs, and Exam Papers).

Reach out to us at following for Classes, Mock Tests, Notes and Guidance:-

- **Telegram Channel** – AIR1CA Guidance & Notes
- **Android App** – AIR1CA Career Institute
- **Call/Whatsapp** – 9829292947, 9024119090
- **Youtube** – Atul Agarwal
- **Facebook/ Instagram/ Linkedin** – 14atul15
- **Email** – air1icai@gmail.com

Best Wishes… Radhe Radhe!!

CONTENTS

PART I: DIRECT TAX LAWS (70 Marks)		
Chapter No.	**Chapter Name**	**Page No.**
1	Basic Concepts	1.1 – 1.4
2	Residence and Scope of Total Income	2.1 – 2.6
3	Incomes which do not form part of Total Income	3.1 – 3.10
6	Profits and Gains of Business or Profession	6.1 – 6.80
7	Capital Gains	7.1 – 7.42
8	Income from Other Sources	8.1 – 8.16
9	Income of Other Persons included in assessee Total Income	9.1 – 9.9
10	Set-off and Carry forward of Losses	10.1 – 10.10
11	Deductions from Gross Total Income	11.1 – 11.21
12	Assessment of Various Entities	12.1 – 12.54
13	Charitable Trusts, Political Parties and Electoral Trusts	13.1 – 13.30
14	Tax Planning, Tax Avoidance & Tax Evasion	14.1 – 14.7
15	Deduction, Collection and Recovery of Tax	15.1 – 15.37
16	Income-tax Authorities	16.1 – 16.7
17	Assessment Procedure	17.1 – 17.19
18	Appeals and Revision	18.1 – 18.11
19	Settlement of Tax Cases	19.1 – 19.6
20	Penalties	20.1 – 20.11
21	Offences and Prosecution	21.1 – 21.2
22	Liability in Special Cases	22.1 – 22.3
23	Miscellaneous Provisions	23.1 – 23.7
PART II: INTERNATIONAL TAXATION (30 Marks)		
1	Transfer Pricing	1.1 – 1.20
2	Non-resident Taxation	2.1 – 2.36
3	Double Taxation Relief	3.1 – 3.17
4	Advance Rulings	4.1 – 4.4
5	Equalisation Levy	5.1 – 5.4
6	Application and Interpretation of Tax Treaties	6.1 – 6.5
7	Fundamentals of BEPS	7.1 – 7.6
8	Overview of Model Tax Conventions	8.1 – 8.4

CHAPTER - 1
Basic Concepts

Section A – ICAI Study Material Questions

Question 1

Mr. Bhargava, a leading advocate on corporate law, decided to reduce his practice and to accept briefs only for paying his taxes and making charities with the fees received on such briefs. In a particular case, he agreed to appear to defend one company in the Supreme Court on the condition that he would be provided with ₹ 5 lacs for a public charitable trust that he would create. He defended the company and was paid the sum by the company. He created a trust of that sum by executing a trust deed. Decide whether the amount received by Mr. Bhargava is assessable in his hands as income from profession.

Answer

In the instant case, the trust was created by Mr. Bhargava himself out of his professional income. The client did not create the trust. The client did not impose any obligation in the nature of a trust binding on Mr. Bhargava. Thus, there is no diversion of the money to the trust before it became professional income in the hands of Mr. Bhargava. This case is one of application of professional income and not of diversion of income by overriding title. Therefore, the amount received by Mr. Bhargava is chargeable to tax under the head "Profits and gains of business or profession".

Question 2

XYZ Ltd. took over the running business of a sole-proprietor by a sale deed. As per the sale deed, XYZ Ltd. undertook to pay overriding charges of ₹ 15,000 p.a. to the wife of the sole-proprietor in addition to the sale consideration. The sale deed also specifically mentioned that the amount was charged on the net profits of XYZ Ltd., who had accepted that obligation as a condition of purchase of the going concern. Is the payment of overriding charges by XYZ Ltd. to the wife of the sole-proprietor in the nature of diversion of income or application of income? Discuss.

Answer

This issue came up for consideration before the Allahabad High Court in Jit & Pal X-Rays (P.) Ltd. v. CIT (2004) 267 ITR 370 (All)**.** The Allahabad High Court observed that the overriding charge which had been created in favour of the wife of the sole-proprietor was an integral part of the sale deed by which the going concern was transferred to the assessee. The obligation, therefore, was attached to the very source of income i.e. the going concern transferred to the assessee by the sale deed. The sale deed also specifically mentioned that the amount in question was charged on the net profits of the assessee-company and the assessee-company had accepted that obligation as a condition of purchase of the going concern. Hence, it is clearly a case of diversion of income by an overriding charge and not a mere application of income.

Question 3

MKG Agency is a partnership firm consisting of father and three major sons. The partnership deed provided that after the death of father, the business shall be continued by the sons, subject to the condition that the firm shall pay 20% of the profits to the mother. Father died in March, 2019. In the previous year 2019-20, the reconstituted firm paid ₹ 1 lakh (equivalent to 20% of the profits) to the mother and claimed the amount as deduction from its income. Examine the correctness of the claim of the firm.

Answer

The issue raised in the problem is based on the concept of diversion of income by overriding title, which is well recognised in the income-tax law. In the instant case, the amount of ₹ 1 lakh, being 20% of profits of the firm, paid to the mother gets diverted at source by the charge created in her favour as per the terms of the partnership deed. Such income does not reach the assessee-firm.

Rather, such income stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said amount but it so received for and on behalf of the mother, who possesses the overriding title. Therefore, the amount paid to the mother should be excluded from the income of the firm. This view has been confirmed in CIT vs. Nariman B. Bharucha & Sons (1981) 130 ITR 863 (Bom).

Question 4

Anand was the Karta of HUF. He died leaving behind his major son Prem, his widow, his grandmother and brother's wife. Can the HUF retain its status as such or the surviving persons would become co-owners?

Answer

In the case of Gowli Buddanna v. CIT (1966) 60 ITR 293, the Supreme Court has made it clear that there need not be more than one male member to form a HUF as a taxable entity under the Income-tax Act, 1961. The expression "Hindu Undivided Family" in the Act is used in the sense in which it is understood under the personal law of the Hindus.

Under the Hindu system of law, a joint family may consist of a single male member and the widows of the deceased male members and the Income-tax Act, 1961 does not mandate that it should consist of at least two male members. Therefore, property of a joint Hindu family does not cease to belong to the family merely because the family is represented by a single co-parcener who possesses the right which an owner of property may possess.

Therefore, the HUF would retain its status as such.

Question 5

Mr. C borrowed on Hundi, a sum of ₹ 25,000 by way of bearer cheque on 11-09-2019 and repaid the same with interest amounting to ₹ 30,000 by account payee cheque on 12-10-2019. The Assessing Officer (AO) wants to treat the amount borrowed as income during the previous year. Is the action of AO valid?

Answer

Section 69D provides that where any amount is borrowed on a hundi or any amount due thereon is repaid otherwise than by way of an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount for the previous year in which the amount was so borrowed or repaid, as the case may be.

In this case, Mr. C has borrowed ₹ 25,000 on Hundi by way of bearer cheque. Therefore, it shall be deemed to be income of Mr. C for the previous year 2019-20. Since the repayment of the same along with interest was made by way of account payee cheque, the same would not be hit by the provisions of section 69D. Therefore, the action of the Assessing Officer treating the amount borrowed as income during the previous year is valid in law.

Question 6

The Assessing Officer found, during the course of assessment of a firm, that it had paid rent in respect of its business premises amounting to ₹ 60,000, which was not debited in the books of account for the year ending 31.3.2020. The firm did not explain the source for payment of rent. The Assessing Officer proposes to make an addition of ₹ 60,000 in the hands of the firm for the assessment year 2020-21. The firm claims that even if the addition is made, the sum of ₹ 60,000 should be allowed as deduction while computing its business income since it has been expended for purposes of its business. Examine the claim of the firm.

Answer

The claim of the firm for deduction of the sum of ₹ 60,000 in computing its business income is not tenable. The action of the Assessing Officer in making the addition of ₹ 60,000, being the payment of rent not debited in the books of account (for which the firm failed to explain the source of payment) is correct in law since the same is an unexplained expenditure under section 69C. The proviso to section 69C states that such unexplained expenditure, which is deemed to be the income of the assessee, shall not be allowed as a deduction under any head of income. Therefore, the claim of the firm is not tenable.

Section B – Additional Questions

Question 7

MNO Limited is engaged in manufacturing activities. It received liquidated damages of ₹ 10 lakh from supplier of machinery due to delay in supply of machinery. State, with reasons whether or not the income by way of liquidated damages is a revenue receipt subject to income-tax.

Answer

The issue under consideration in this case is whether the liquidated damages received by a company from the supplier of machinery for delay in supply of machinery is revenue in nature.

On this issue, the Apex Court, in the case of CIT v. Saurashtra Cement Ltd. (2010) 325 ITR 422, held that such liquidated damages were directly and intimately linked with the procurement of a capital asset which lead to delay in coming into existence of the profit- making apparatus. It was not a receipt in the course of profit earning process. Therefore, the amount received by the assessee towards compensation for sterilization of the profit earning source, not in the ordinary course of business, is a capital receipt in the hands of the assessee.

Applying the rationale of the above Apex Court ruling in this case, the income by way of liquidated damages of ₹ 10 lakh received by MNO Ltd. from the supplier of machinery is a capital receipt.

Question 8

In the course of scrutiny assessment of Mr. X, the Assessing Officer, on the basis of information available with him, sought an explanation for the source of the expenditure of ₹ 20 lakhs incurred on the wedding of his daughter. The said expenditure was neither recorded in the books of account maintained nor was the explanation offered by Mr. X satisfactory. What are the consequences?

Answer

If any expenditure is incurred by an assessee in any financial year in respect of which he is not able to offer explanation about the source of such expenditure or the explanation offered by him is not satisfactory in the opinion of the Assessing Officer, then the amount of such unexplained expenditure may be deemed as income of the assessee for such financial year as per section 69C.

Therefore, in this case the expenditure of ₹ 20 lakhs incurred by Mr. X on the wedding of his daughter may be deemed as income of Mr. X as per section 69C.

Further, such unexplained expenditure which is deemed as the income of Mr. X shall not be allowed as deduction under any head of income.

Where the total income of Mr. X includes such unexplained expenditure of ₹ 20 lakhs, which is deemed as his income under section 69C, such deemed income would be taxed at the rate of 60% as per section 115BBE (plus surcharge 25%, education cess@4%)

Further, no basic exemption or allowance or expenditure shall be allowed to Mr. X under any provision of the Income-tax Act, 1961 in computing such deemed income.

CHAPTER - 2
Residence and Scope of Total Income

Section A – ICAI Study Material Questions

Question 1

Brett Lee, an Australian cricket player visits India for 100 days in every financial year. This has been his practice for the past 10 financial years. Find out his residential status for the assessment year 2020-21.

Answer

Determination of Residential Status of Mr. Brett Lee for the A.Y. 2020-21:-

Period of stay during the previous year 2019-20 = 100 days

Calculation of period of stay during 4 preceding previous years (100 x 4=400 days)

P.Y.2018-19	100 days
P.Y.2017-18	100 days
P.Y.2016-17	100 days
P.Y.2015-16	100 days
Total	**400 days**

Mr. Brett Lee has been in India for a period of more than 60 days during previous year 2019-20 and for a period of more than 365 days during the 4 immediately preceding previous years. Therefore, since he satisfies one of the basic conditions under section 6(1), he is a resident for the assessment year 2020-21.

Computation of period of stay during 7 preceding previous years = 100 x 7=700 days

2018-19	100 days
2017-18	100 days
2016-17	100 days
2015-16	100 days
2014-15	100 days
2013-14	100 days
2012-13	100 days
Total	**700 days**

Since his period of stay in India during the past 7 previous years is less than 730 days, he is a not-ordinarily resident during the assessment year 2020-21. (See Note below)
Therefore, Mr. Brett Lee is a resident but not ordinarily resident during the previous year 2019-20 relevant to the assessment year 2020-21.

Question 2

Mr. Anand is an Indian citizen and a member of the crew of a Singapore bound Indian ship engaged in carriage of passengers in international traffic departing from Chennai port on 6th June, 2019. From the following details for the P.Y.2019-20, determine the residential status of Mr. Anand for A.Y.2020-21, assuming that his stay in India in the last 4 previous years (preceding P.Y.2019-20) is 400 days and last seven previous years (preceding P.Y.2019-20) is 750 days:

Particulars	Date
Date entered into the Continuous Discharge Certificate in respect of joining the ship by Mr. Anand	6th June, 2019
Date entered into the Continuous Discharge Certificate in respect of signing off the ship by Mr. Anand	9th December, 2019

Answer

In this case, the voyage is undertaken by an Indian ship engaged in the carriage of passengers in international traffic, originating from a port in India (i.e., the Chennai port) and having its destination at a port outside India (i.e., the Singapore port). Hence, the voyage is an eligible voyage for the purposes of section 6(1).

Therefore, the period beginning from 6th June, 2019 and ending on 9th December, 2019, being the dates entered into the Continuous Discharge Certificate in respect of joining the ship and signing off from the ship by Mr. Anand, an Indian citizen who is a member of the crew of the ship, has to be excluded for computing the period of his stay in India. Accordingly, 187 days [25+31+31+30+31+30+9] have to be excluded from the period of his stay in India. Consequently, Mr. Anand's period of stay in India during the P.Y.2019-20 would be 179 days [i.e., 366 days – 187 days]. Since his period of stay in India during the P.Y.2019-20 is less than 182 days, he is a non-resident for A.Y.2020-21.

Note - Since the residential status of Mr. Anand is "non-resident" for A.Y.2020-21 consequent to his number of days of stay in P.Y.2019-20 being less than 182 days, his period of stay in the earlier previous years become irrelevant.

Question 3

The business of a HUF is transacted from Australia and all the policy decisions are taken there. Mr. E, the karta of the HUF, who was born in Kolkata, visits India during the P.Y.2019-20 after 15 years. He comes to India on 1.4.2019 and leaves for Australia on 1.12.2019. Determine the residential status of Mr. E and the HUF for A.Y.2020-21.

Answer

(a) During the P.Y.2019-20, Mr. E has stayed in India for 245 days (i.e., 30+31+30+31+31+ 30+31+30+1 days). Therefore, he is a resident. However, since he has come to India after 15 years, he does not satisfy any of the conditions for being ordinarily resident.

Therefore, the residential status of Mr. E for the P.Y.2019-20 is resident but not ordinarily resident.

(b) Since the business of the HUF is transacted from Australia and nothing is mentioned regarding its control and management, it is assumed that the control and management is also wholly outside India since policy decisions are taken there. Therefore, the HUF is a non-resident for the P.Y.2019-20.

Question 4

From the following particulars of income furnished by Mr. Anirudh pertaining to the year ended 31.3.2020, compute the total income for the assessment year 2020-21, if he is:

(i) Resident and ordinary resident;
(ii) Resident but not ordinarily resident;
(iii) Non-resident

	Particulars	₹
(a)	Short-term capital gains on sale of shares in an Indian Company received in Germany	15,000
(b)	Dividend from a Japanese Company received in Japan	10,000
(c)	Rent from property in London deposited in a bank in London, later on remitted to India through approved banking channels	75,000
(d)	Dividend from RP Ltd., an Indian Company	6,000
(e)	Agricultural income from lands in Gujarat	25,000

Answer

Computation of total income of Mr. Anirudh for the A.Y. 2020-21

Particulars	Resident & ordinarily resident (₹)	Resident but not ordinarily resident (₹)	Non-Resident (₹)
1) Short term capital gains on sale of shares of an Indian company, received in Germany	15,000	15,000	15,000
2) Dividend from a Japanese company, received in Japan	10,000	-	-
3) Rent from property in London deposited in a bank in London **[See Note (i) below]**	52,500	-	-
4) Dividend from RP Ltd., an Indian Company **[See Note (ii) below]**	-	-	-
5) Agricultural income from land in Gujarat **[See Note (iii) below]**	-	-	-
Total Income	**77,500**	**15,000**	**15,000**

Notes:

(i) It has been assumed that the rental income is the gross annual value of the property. Therefore, deduction @30% under section 24, has been provided and the net income so computed is taken into account for determining the total income of a resident and ordinarily resident.

Particulars	₹
Rent received (assumed as gross annual value)	75,000
Less: Deduction under section 24 (30% of ₹75,000)	22,500
Income from house property	**52,500**

(ii) Dividend received from Indian company upto ₹ 10 lakh is exempt under section 10(34).

(iii) Agricultural income is exempt under section 10(1).

Question 5

Poulomi, a chartered accountant, is presently working in a firm in India. She has received an offer for the post of Chief Financial Officer from a company at Singapore. As per the offer letter, she should join the company at any time between 1st September, 2019 and 31st October, 2019. She approaches you for your advice on the following issues to mitigate her tax liability in India:

(i) Date by which she should leave India to join the company;

(ii) Direct credit of part of her salary to her bank account in Kolkata maintained jointly with her mother to meet requirement of her family

(iii) Period for which she should stay in India when she comes on leave.

Answer

The following category of individuals will be treated as resident in India only if the period of their stay in India during the relevant previous year is 182 days or more :-

(a) Indian citizens, who leave India in any previous year, inter alia, for purposes of employment outside India, or

(b) Indian citizen or person of Indian origin engaged outside India, inter alia, in an employment, who comes on a visit to India in any previous year.

(i) Since Poulomi is leaving India for the purpose of employment outside India, she will be treated as resident only if the period of her stay during the previous year amounts to 182 days or more. Therefore, Poulomi should leave India on or before 28th September, 2019, in which case, her stay in India during the previous year would be less than 182 days and she would become non-resident for the purpose of taxability in India. In such a case, only the income which accrues or arises in India or which is deemed to accrue or arise in India or received or deemed to be received in India shall be taxable.

The income earned by her in Singapore would not be chargeable to tax in India for A.Y. 2020-21, if she leaves India on or before 28th September, 2019.

(ii) If any part of Poulomi's salary will be credited directly to her bank account in Kolkata then, that part of her salary would be considered as income received in India during the previous year under section 5 and would be chargeable to tax under Income-tax Act, 1961, even if she is a non-resident. Therefore, Poulomi should receive her entire salary in Singapore and then remit the required amount to her bank account in Kolkata in which case, the salary earned by her in Singapore would not be subject to tax in India.

(iii) In case Poulomi visits India after taking up employment outside India, she would be covered in the exception provided in (b) above and she will be treated as resident only if the period of her stay during the relevant previous year amounts to 182 days or more.

Therefore, when Poulomi comes India on leave, she should stay in India for less than 182 days during the relevant previous year so that her status remains as a non-resident for the relevant previous year. Moreover, she should not visit India again during the current previous year i.e. P.Y. 2019-20.

Section B – Additional Questions

Question 6

Peeyush, returned to India on 12th June, 2019 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various income and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2020-21:

(i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2019.

(ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of ₹ 75,000 in U.K. in foreign currency (not received in India) and of ₹ 20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at ₹ 37,500 while in terms of Indian Rupee it was ₹ 50,000.

Answer

Peeyush returned to India on 12th June 2019 for permanently residing in India after staying in UK for 20 years. During the P.Y.2019-20, he stays in India for 294 days. Since he has stayed in India for a period of 182 days or more during the previous year 2019-20, he would be a resident in India for the A.Y.2020-21. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2019-20 / his stay in India during the seven previous years is less than 730 days. The residential status of Peeyush for A.Y.2020-21 is, therefore, **Resident But Not Ordinarily Resident.**

As per section 5(1), only income which is received/deemed to be received/accrued or arisen/deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of ₹ 1,500 per child under section 10(32).

Accordingly, income of ₹ 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of ₹ 1,500. Therefore, ₹18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Peeyush.

Since the other son is major, his income is not includible in the income of Peeyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Peeyush was a non-resident, is not taxable in the A.Y.2020-21 since it is not the income of the P.Y.2019-20.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2020-21. Since his total income (i.e., ₹ 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2020-21.

Question 7

Arjun who works as a Finance Controller of ABC Ltd. was deputed to work at the company's office in U.K. on 26.09.2019 for a period of 2 years. He claims that he is a non-resident for the A.Y.2020-21. Is his claim valid? Discuss.

Answer

As per section 6, an individual is treated as resident if he has stayed for 182 days in India during the previous year or if he has stayed for 60 days in the current previous year and 365 days in total during the four preceding previous years. However, where an Indian citizen leaves India for the purpose of employment, he will be resident if he stayed for 182 days instead of 60 days during the previous year.

In the given case, Arjun is employed in India and he was deputed to work at the company's branch office in U.K. on 26.09.2019 for a period of 2 years. Since, Arjun leaves India for the purpose of employment, the condition of 182 days in the current previous year would only be applicable for treating him as resident. However, during the P.Y. 2019-20, he stayed in India for 179 days. Hence, his claim that he is non-resident for the A.Y. 2020-21, is valid.

CHAPTER - 3
Income which do not form part of Total Income

Section A – ICAI Study Material Questions

Question 1

Mr. B grows sugarcane and uses the same for the purpose of manufacturing sugar in his factory. 30% of sugarcane produce is sold for ₹ 10 lacs, and the cost of cultivation of such sugarcane is ₹ 5 lacs. The cost of cultivation of the balance sugarcane (70%) is ₹ 14 lacs and the market value of the same is ₹ 22 lacs. After incurring ₹ 1.5 lacs in the manufacturing process on the balance sugarcane, the sugar was sold for ₹ 25 lacs. Compute B's business income and agricultural income.

Answer

Computation of Business Income and Agriculture Income of Mr. B

Particulars	Business Income	Agricultural Income	
	(₹)	(₹)	(₹)
Sale of Sugar			
Business income			
Sale Proceeds of sugar	25,00,000		
Less: Market value of sugar (70%)	22,00,000		
Less: Manufacturing exp.	1,50,000		
	1,50,000		
Agricultural income			
Market value of sugar (70%)		22,00,000	
Less: Cost of cultivation		14,00,000	
			8,00,000
Sale of sugarcane			
Agricultural Income			
Sale proceeds of sugarcane (30%)		10,00,000	
Less: Cost of cultivation		5,00,000	
			5,00,000
			13,00,000

Question 2

Mr. C manufactures latex from the rubber plants grown by him in India. These are then sold in the market for ₹ 30 lacs. The cost of growing rubber plants is ₹ 10 lacs and that of manufacturing latex is ₹ 8 lacs. Compute his total income.

Answer

The total income of Mr. C comprises of agricultural income and business income.

Total profits from the sale of latex = ₹ 30 lacs – ₹ 10 lacs – ₹ 8 lacs = ₹ 12

lacs. Agricultural income = 65% of ₹ 12 lacs = ₹ 7.8 lacs

Business income = 35% of ₹ 12 lacs = ₹ 4.2 lacs

Question 3

Ankur, the owner of a land situated in Kerala used for growing thereon different types of fruits, paddy, vegetables and flowers, received from Yahoo Movies Ltd., Chennai, ₹ 5 lacs as rent towards the use of this land for shooting of a film. The amount so received was accounted by him in the books as revenue derived from land and claimed to be exempt under section 10(1). He now wants to confirm from you whether the amount has been correctly treated by him as agricultural income.

Answer

The income received by Mr. Ankur from a filmmaker for allowing them to shoot a film in the agricultural land owned by him is not in the nature of agricultural income because it was neither received by him against the sale of agricultural produce obtained nor for carrying out the normal agricultural operations on the land. The amount paid was only for the purpose of shooting of a film on such land.

To claim exemption in respect of agricultural income under section 10(1), the conditions contained in section 2(1A)(a) to (c) have to be first complied with/ fulfilled by the assessee. The Madras High Court in the case of B. Nagi Reddi v. CIT (2002) 258 ITR 719, following the judgment of Apex Court in the case of CIT v Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466, has held, on identical facts, that the income derived for allowing a shooting of film in the agricultural land cannot be treated as agricultural income, as it has no nexus with the land, except that it was carried out on agricultural land.

Question 4

Mr. X, a resident, has provided the following particulars of his income for the P.Y.2019-20.

Income from salary (computed)	- ₹ 2,80,000
Income from house property (computed)	- ₹ 2,50,000
Agricultural income from a land in Jaipur	- ₹ 4,80,000
Expenses incurred for earning agricultural income	- ₹ 1,70,000

Compute his tax liability assuming his age is 45 years

Answer

Computation of total income of Mr. X for the A.Y. 2020-21

(a) Computation of tax liability (age 45 years)

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.

1. Net agricultural income exceeds ₹ 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit of ₹ 2,50,000.

His tax liability is computed in the following manner:

Particulars	₹	₹
Income from salary		2,80,000
Income from house property		2,50,000
Net agricultural income [₹ 4,80,000 (-) ₹1,70,000]	3,10,000	
Less: Exempt under section 10(1)	(3,10,000)	-

Gross Total Income		**5,30,000**
Less: Deductions under Chapter VI-A		-
Total Income		**5,30,000**

Step 1 : ₹ 5,30,000 + ₹3,10,000 = ₹ 8,40,000
Tax on ₹ 8,40,000 = ₹ 80,500
(i.e., 5% of ₹ 2,50,000 plus 20% of ₹ 3,40,000)

Step 2 : ₹ 3,10,000 + ₹2,50,000 = ₹ 5,60,000
Tax on ₹ 5,60,000 = ₹ 24,500
(i.e. 5% of ₹ 2,50,000 plus 20% of ₹ 60,000)

Step 3 : ₹ 80,500 – ₹24,500 = ₹ 56,000

Step 4 & 5 : Total tax payable = ₹ 56,000
= ₹56,000 + 4% of ₹56,000 = ₹ 58,240.

Question 5

An amount of ₹ 5 lacs was paid on 17.3.2020 to the parents of Amit by the Government of Chattisgarh as compensation to the aggrieved family, whose only son Amit lost his life in Maoist local bus bomb blast in Dantewada.

Examine with reasons, whether the amount of compensation received is chargeable to tax in A.Y. 2020-21?

Answer

As per section 10(10BC), the meaning of "disaster" shall be derived from Disaster Management Act, 2005 which defines disaster to mean a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or manmade causes, or by accident or negligence. It should have the effect of causing substantial loss of life or human suffering or damage to, and destruction of property, or damage to, or degradation of environment. It should be of such a nature or magnitude to be beyond the coping capacity of the community of the affected area.
If, for this reason, any compensation is paid by the Central Government or by a State Government or by a local authority, then, the same will be exempt from tax. Accordingly, the amount of ₹ 5 lacs received by the parents of deceased Amit from the Government of Chattisgarh for the disaster because of Dantewada bus bomb blast is exempt under section 10(10BC).

Question 6

Ms. J, a Sikkimese woman, married Mr. K, a non-Sikkimese, on 1st January, 2008. During the previous year 2019-20, she received rent of ₹ 12 lacs from letting out of house properties situated in the State of Sikkim. Is she liable to income-tax for assessment year 2020-21? Will your answer be different, if she had married Mr. K on 16th April, 2008?

Answer

Section 10(26AAA) provides that the following income, which accrues or arises to a Sikkemese individual, shall be exempt from income-tax:

(a) Income from any source in the State of Sikkim; and

(b) Income by way of dividend or interest on securities.

However, the aforesaid exemption will not be available to a Sikkimese woman, who marries a non-Sikkemese individual on or after 1st April, 2008.

Since Ms. J, the assessee, married Mr. K on 1st January, 2008, income derived by her by way of rent from properties situated in the State of Sikkim shall be exempt under section 10(26AAA).
However, if she had married Mr. K on 16th April, 2008, the exemption would not be available.
Note: The restriction in section 10(26AAA) applies only to Sikkimese women and not to men who are eligible for the exemption in respect of the above said incomes regardless of their marrying Sikkemese or non-Sikkemese women.

Question 7

Y Ltd. furnishes you the following information for the year ended 31.3.2020:

Particulars	₹ (in lacs)
Total turnover of Unit A located in Special Economic Zone	100
Profit of the business of Unit A	30
Export turnover of Unit A	50
Total turnover of Unit B located in Domestic Tariff Area (DTA)	200
Profit of the business of Unit B	20

Compute deduction under section 10AA for the A.Y. 2020-21, assuming that Y Ltd. commenced operations in SEZ and DTA in the year 2016-17.

Answer

100% of the profit derived from export of articles or things or services is eligible for deduction under section 10AA, since F.Y.2019-20 falls within the first five year period commencing from the year of manufacture or production of articles or things or provision of services by the Unit in SEZ. As per section 10AA(7), the profit derived from export of articles or things or services shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of articles or things or services bears to the total turnover of the business carried on by the undertaking.

Deduction under section 10AA = 30 Lacs*50/100 = 15 Lacs
Note – No deduction under section 10AA is allowable in respect of profits of business of Unit B located in DTA.

Question 8

Examine with reasons, based on the provisions of the Act, as to chargeability of the following receipts to tax in the assessment year 2020-21:

(i) Rent of ₹ 60,000 charged from tenants occupying houses constructed on the land situated in India and used for agricultural purposes. The tenants, working in the nearby industrial area, occupy these houses for their own residential purposes.

(ii) Income of ₹ 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land.

(iii) Mr. Gaitonde, born and brought up in the State of Sikkim, had a net profit of ₹ 2,25,000 from the business located in Sikkim and interest of ₹ 55,000 on the securities/ bonds issued by the Government of Rajasthan.

Answer

(i) As per section 10(1), agricultural income is exempt from tax. The meaning and scope of agricultural income is defined in section 2(1A). According to Explanation 2 to section 2(1A), any income derived from any building from the use of such building for any purpose (including letting for residential purposes or for the purpose of any business or profession) other than agriculture shall not be agricultural income. Therefore, the rent of ₹ 60,000 from letting out of houses constructed on agricultural land for residential purposes of industrial workers shall not be treated as agricultural income by virtue of Explanation 2 to section 2(1A). Hence, such income would be chargeable to tax.

(ii) Explanation 3 to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income, whether or not the basic operations were carried out on land. Accordingly, the income of ₹ 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land shall be treated as agricultural income and exempt from tax under section 10(1).

(iii) Section 10(26AAA) exempts the income which accrues or arises to a Sikkimese individual from any source in the State of Sikkim and the income by way of dividend or interest on securities. Therefore, the income of Mr. Gaitonde from a business located in Sikkim and interest income on the securities/bonds of Government of Rajasthan shall not be subject to tax.

Question 9

Rudra Ltd. has one unit at Special Economic Zone (SEZ) and other unit at Domestic Tariff Area (DTA). The company provides the following details for the previous year 2019-20.

Particulars	Rudra Ltd. (₹)	Unit in DTA (₹)
Total Sales	6,00,00,000	2,00,00,000
Export Sales	4,60,00,000	1,60,00,000
Net Profit	80,00,000	20,00,000

Calculate the eligible deduction under section 10AA of the Income-tax Act, 1961, for the Assessment Year 2020-21, in the following situations:

(i) If both the units were set up and start manufacturing from 22-05-2012.

(ii) If both the units were set up and start manufacturing from 14-05-2016.

Answer

Computation of deduction under section 10AA of the Income-tax Act, 1961

As per section 10AA, in computing the total income of Rudra Ltd. from its unit located in a Special Economic Zone (SEZ), which begins to manufacture or produce articles or things or provide any services during the previous year relevant to the assessment year commencing on or after 01.04.2006 but before 1.4.2021, there shall be allowed a deduction of 100% of the profit and gains derived from export of such articles or things or from services for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and 50% of such profits for further five assessment years subject to fulfillment of other conditions specified in section 10AA.

Computation of eligible deduction under section 10AA [See Working Note below]:

(i) <u>If Unit in SEZ was set up and began manufacturing from 22-05-2012:</u>

Since A.Y. 2020-21 is the 8th assessment year from A.Y. 2013-14, relevant to the previous year 2012-13, in which the SEZ unit began manufacturing of articles or things, it shall be eligible for deduction of 50% of the profits derived from export of such articles or things, assuming all the other conditions specified in section 10AA are fulfilled.

$$= \text{Profits of Unit in SEZ} \times \frac{\text{Export turnover of Unit in SEZ}}{\text{Total turnover of Unit in SEZ}} \times 50\%$$

$$= ₹60 \text{ lakhs} \times \frac{₹300 \text{ lakhs}}{₹400 \text{ lakhs}} \times 50\% = ₹ 22.50 \text{ lakhs}$$

(ii) <u>If Unit in SEZ was set up and began manufacturing from 14-05-2016:</u>

Since A.Y.2020-21 is the 4th assessment year from A.Y. 2017-18, relevant to the previous year 2016-17, in which the SEZ unit began manufacturing of articles or things, it shall be eligible for deduction of 100% of the profits derived from export of such articles or things, assuming all the other conditions specified in section 10AA are fulfilled.

$$= \text{Profits of Unit in SEZ} \times \frac{\text{Export turnover of Unit in SEZ}}{\text{Total turnover of Unit in SEZ}} \times 100\%$$

$$= ₹60 \text{ lakhs} \times \frac{₹300 \text{ lakhs}}{₹400 \text{ lakhs}} \times 100\% = ₹ 45 \text{ lakhs}$$

The unit set up in Domestic Tariff Area is not eligible for the benefit of deduction under section 10AA in respect of its export profits, in both the situations.

Working Note:

Computation of total sales, export sales and net profit of unit in SEZ

Particulars	Rudra Ltd. (₹)	Unit in DTA (₹)	Unit in SEZ (₹)
Total Sales	6,00,00,000	2,00,00,000	**4,00,00,000**
Export Sales	4,60,00,000	1,60,00,000	**3,00,00,000**
Net Profit	80,00,000	20,00,000	**60,00,000**

Section B – Additional Questions

Question 10

Siddarth Ltd. has an undertaking (Unit-X) in Special Economic Zone (SEZ) and another undertaking (Unit- Y) in Free Trade Zone (FTZ) for manufacturing of computer software. It furnishes the following particulars for its 2nd year of operations ended on 31st March, 2020:

	Unit X ₹ (In Lacs)	Unit Y ₹ (In lacs)
Total Sales:	180	120
Export Sales : (Inclusive of ₹ 10 lacs for onsite development of computer software outside India by Unit X)	120	10
Profit earned [After claim of bad debts under section 36(1)(vii) in Unit X]	63	36

Plant and machinery used in the business has been depreciated at 15% on straight line method (SLM) basis and depreciation of ₹ 9 lacs was charged to profit and loss account in the proportion of sales during the previous year.
₹ 100 lacs were realized out of export sales in time and balance of ₹ 20 lacs becomes irrecoverable due to bankruptcy of one of the foreign buyers in Unit-X.
Compute the deduction under section 10AA of the Income-tax Act, 1961 and taxable income of Siddarth Ltd. for the Assessment Year 2020-21.

Answer

Computation of total income of Siddarth Ltd. for A.Y. 2020-21

Particulars	₹	₹
Profits and gains of business or profession		
Unit X (See Note 4)	63,81,000	
Less: Deduction under section 10AA (See Working below)	35,45,000	28,36,000
Unit Y (See Note 4)		36,54,000
Total Income		**64,90,00**

Deduction under section 10AA in respect of Unit X (See Notes 1, 2 & 3)

= Profits of the business of the undertaking, x $\frac{\text{Export turnover of the undertaking (inrespect of computer software)}}{\text{Total turnover of the business of the undertaking}}$

being the Unit is SEZ

= Profits of Unit X x $\frac{\text{Export turnover of the Unit X}}{\text{Total turnover of Unit X}}$

= Rs. 63,81,000 x $\frac{1,00,00,000}{1,80,00,000}$

= Rs. 35,45,000

Notes:

(1) Deduction under section 10AA is available in respect of units established in Special Economic Zones which begin to manufacture or produce articles or things or provide any services

during the previous year relevant to A.Y.2006-07 or thereafter. Under section 10AA(1), 100% of the profits and gains derived from export of such articles or things or from services is allowable as deduction for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be.

Therefore, in this case, the profits from Unit X, located in a SEZ, will be eligible for deduction of 100% of the profits and gains derived from export, since P.Y.2019-20 is the second year of its operations. It is assumed that Unit X has fulfilled all the specified conditions for claim of deduction. Unit Y is, however, not eligible for deduction under section 10AA in respect of the exports made by it since it is located in a Free Trade Zone.

(2) Export turnover, for the purpose of section 10AA, means the consideration received in respect of export by the unit in SEZ. Therefore, in this case, the amount of ₹ 20,00,000 which has become irrecoverable due to bankruptcy of one of the foreign buyers in Unit X will not be included in its export turnover.

Therefore, export turnover of Unit X (in SEZ) = ₹ 1,20,00,000 – ₹ 20,00,000 = ₹ 1,00,00,000.

(3) Profits and gains from on site development of computer software outside India shall be deemed to be the profits and gains derived from export of computer software outside India. Since the same has already been included in the figure of export sales, no further adjustment is required.

(4) **Computation of unit-wise profits of the business**

Particulars	Unit X (₹)	Unit Y (₹)	Total (₹)
Profit earned [after claim of bad debts under section 36(1)(vii) in Unit X]	63,00,000	36,00,000	99,00,000
Add: Depreciation calculated on SLM basis and charged in the proportion of sales (3:2)	5,40,000	3,60,000	9,00,000
	68,40,000	39,60,000	1,08,00,000
Less: Depreciation calculated @15% on WDV basis and charged in the proportion of sales (3:2) **(See Note 5)**	4,59,000	3,06,000	7,65,000
Profits of the business	**63,81,000**	**36,54,000**	**1,00,35,000**

(5) Depreciation as per the Income-tax Rules, 1962 for the A.Y.2020-21 has to be calculated as follows –

Particulars	₹
Actual cost of plant and machinery (₹ 9,00,000 / 15%)	60,00,000
Less: Depreciation @15% for P.Y.2018-19 (being the first year of operations). It is logical to assume that the assets were put to use for more than 180 days during the year.	9,00,000
Written down value as on 1.4.2019	51,00,000
Depreciation @15% on WDV for P.Y.2019-20 (₹ 51,00,000 × 15%)	**7,65,000**

Question 11

Can the provisions of section 14A of the Income-tax Act, 1961 be applied for disallowing expenditure relating to income for which deduction is available under Chapter VI -A, or the section can be invoked only in respect of expenditure relating to income exempt under the provisions of section 10?

Answer

Chapter III, comprising sections 10 to 13B, deals with incomes which do not form part of total income. As per section 14A(1), for the purposes of computing the total income under Chapter IV, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Income-tax Act, 1961. Therefore, from a plain reading of section 14A, it is apparent that the intention of the section is to disallow expenditure in relation to income which does not form part of total income i.e., expenditure in relation to income exempt under section 10 to 13B.

Therefore, the provisions of section 14A cannot be applied for disallowing expenditure relating to income for which deduction is available under Chapter VIA.

Question 12

Mr. W has provided the following information regarding his income and expenditure of the previous year 2019-20.

Income from business (computed)	₹	5,00,000
Dividend income from Money Market Mutual Funds	₹	1,25,000
Consultancy charges to Mutual Fund agent	₹	15,000
Interest expenditure relating to both taxable and non-taxable income	₹	2,25,000

Value of investments in mutual fund units as on first and last day of the previous year are ₹ 5,00,000 and ₹ 3,00,000.

Value of total assets as appearing in Balance Sheet as on first day and last day of the previous year are ₹ 50,00,000 and ₹ 70,00,000.

Mr. W claims that no expenditure was incurred by him for exempt income earned.

The Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of expenditure in relation to exempt income.

You are required to compute the amount of expenditure incurred in relation to exempt income and resultant total income, assuming that Mr. W has no other income.

Answer

As per section 14A, expenditure incurred in relation to any exempt income is not allowed as deduction. However, if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of expenditure in relation to exempt income, or the claim made by the assessee that no expenditure has been incurred in relation to exempt income for such previous year, he shall determine the amount of expenditure in relation to such income in the manner provided in Rule 8D.

In this case, since the Assessing Officer is not satisfied with the correctness of claim of Mr. W, he shall determine the amount of expenditure in relation to exempt income in the manner provided in Rule 8D.

Dividend income of ₹ 1,25,000 from mutual fund is exempt under section 10(35). Therefore, dividend income represents exempt income of Mr. W.

	Particulars	₹

(i)	**The amount of expenditure directly relating to exempt income** Consultancy charges paid to Mutual Fund Agent	15,000
(ii)	**Calculation of interest expenditure attributable to exempt income** Interest expenditure incurred × (Average value of investment in Mutual Fund Units as on the first and last day of the previous year) / (Average of total assets of the assessee as appearing in the Balance Sheet, on the first day and last day of the previous year)	
	$= 2,25,000 \times \frac{[(5,00,000+3,00,000)/2]}{[(5,00,000+70,00,000)/2]}$	
	$= 2,25,000 \times \frac{4,00,000}{60,00,000}$	15,000
(iii)	**Half per-cent of the average value of investment income from which is exempt from tax i.e., ½% of the average value of investment in mutual funds.** **₹ 4,00,000 x ½%**	2,000
Amount of expenditure in relation to exempt income		**32,000**

Computation of total income of Mr. W for the A.Y. 2020-21

Particulars	Amount
Income from business (computed)	5,00,000
Add: Amount of expenditure in relation to exempt income (See Note below)	32,000
Income from business / Total Income	**5,32,00**

Note - Since it has been stated in the question that Mr. W claims that no expenditure was incurred by him for exempt income earned, it is logical to assume that the entire interest expenses of ₹ 2,25,000 has been deducted to arrive at the income from business of ₹ 5,00,000. Therefore, the amount of interest expenses in relation to exempt income has been added back to compute the resultant total income.

Question 13

Amit, a captain in Indian army, was killed at Kashmir border during a war. The widow of Amit was paid an ex-gratia payment of ₹ 5,00,000 in March, 2020, besides the family pension during the year of ₹ 2,40,000. She wants to know the taxability of both the receipts. Decide.

Answer

According to CBDT Circular No.776 of June 8, 1999, any lump sum ex-gratia payment made by the Central Government / State Government/Local Authority or Government, public sector undertaking, to the widow or other legal heirs of an employee, who dies while in active service, will not be taxable as income under the Income-tax Act, 1961. Therefore, ₹ 5,00,000 is not taxable.

Section 10(19) grants tax exemption in respect of family pension if a member of the armed forces dies in the course of operational duties. Hence, if captain Amit had died in the course of operational duties, the family pension received by widow of captain Amit is fully exempt from tax.

CHAPTER - 6
Profits & Gains of Business or Profession

Section A – ICAI Study Material Questions

Question 1

Mr. X, a proprietor engaged in manufacturing business, furnishes the following particulars:

	Particulars	₹
(1)	Opening WDV of plant and machinery as on 1.4.2019	30,00,000
(2)	New plant and machinery purchased and put to use on 08.06.2019	20,00,000
(3)	New plant and machinery acquired and put to use on 15.12.2019	8,00,000
(4)	Computer acquired and installed in the office premises on 2.1.2020	3,00,000

Compute the amount of depreciation and additional depreciation as per the Income-tax Act, 1961 for the A.Y. 2020-21. Assume that all the assets were purchased by way of account payee cheque.

Answer

Computation of depreciation and additional depreciation for A.Y. 2020-21

Particulars	Plant & Machinery (15%) (₹)	Computer (40%) (₹)
Normal depreciation		
• @ 15% on ₹ 50,00,000 [See Working Notes 1 & 2]	7,50,000	-
• @ 7.5% (50% of 15%, since put to use for less than 180 days) on ₹ 8,00,000	60,000	-
• @ 20% (50% of 40%, since put to use for less than 180 days) on ₹ 3,00,000	-	60,000
Additional Depreciation		
• @ 20% on ₹ 20,00,000 (new plant and machinery put to use for more than 180 days)	4,00,000	-
• @10% (50% of 20%, since put to use for less than 180 days) on ₹ 8,00,000	80,000	-
Total depreciation	**12,90,000**	**60,000**

Working Notes:

(1) Computation of written down value of Plant & Machinery as on 31.03.2020

Particulars	Plant & Machinery (₹)	Computer (₹)
Written down value as on 1.4.2019	30,00,000	-
Add: Plant & Machinery purchased on 08.6.2019	20,00,000	-
Add: Plant & Machinery acquired on 15.12.2019	8,00,000	-
Computer acquired and installed in the office premises	-	3,00,000
Written down value as on 31.03.2020	**58,00,000**	**3,00,000**

(2) Composition of plant and machinery included in the WDV as on 31.3.2020

Particulars	Plant & Machinery (₹)	Computer (₹)
Plant and machinery put to use for 180 days or more [₹30,00,000(Opening WDV) +₹ 20,00,000 (purchased on 8.6.2019)]	50,00,000	
Plant and machinery put to use for less than 180 days	8,00,000	
Computers put to use for less than 180 days		3,00,000
	58,00,000	**3,00,000**

Notes:

1. As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount of deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

   Therefore, normal depreciation on plant and machinery acquired and put to use on 15.12.2019 and computer acquired and installed on 02.01.2020, is restricted to 50% of 15% and 40%, respectively. The additional depreciation on the said plant and machinery is restricted to ₹ 80,000, being 10% (i.e., 50% of 20%) of ₹ 8 lakh.

2. As per third proviso to section 32(1)(ii), the balance additional depreciation of ₹ 80,000 being 50% of ₹ 1,60,000 (20% of ₹ 8,00,000) would be allowed as deduction in the A.Y.2021-22

3. As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, inter alia, in the business of manufacture or production of any article or thing, @20% of the actual cost of such machinery or plant.
   However, additional depreciation shall not be allowed in respect of, inter alia, any machinery or plant installed in office premises, residential accommodation or in any guest house.
   Accordingly, additional depreciation is not allowable on computer installed in the office premises.

Question 2

A newly qualified Chartered Accountant Mr. Dhaval, commenced practice and has acquired the following assets in his office during F.Y. 2019-20 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y.2020-21. Assume that all the assets were purchased by way of account payee cheque.

Sl. No.	Description	Date of acquisition	Date when put to use	Amount ₹
1.	Computer including computer software	27 Sept., 19	1 Oct., 19	35,000
2.	Computer UPS	2 Oct., 19	8 Oct., 19	8,500
3.	Computer printer	1 Oct., 19	1 Oct., 19	12,500
4.	Books (of which books being annual publications are of ₹ 12,000)	1 Apr., 19	1 Apr., 19	13,000
5.	Office furniture (Acquired from a practising CA)	1 Apr., 19	1 Apr., 19	3,00,000
6.	Laptop	26 Sep., 19	8 Oct., 19	43,000

Answer

Computation of depreciation allowable for A.Y.2020-21

Asset		Rate	Depreciation
Block 1	Furniture **[See working note below]**	10%	30,000
Block 2	Plant (Computer including computer software, computer UPS, laptop, computer printer & books)	40%	34,500
Total depreciation allowable			**64,500**

Working Notes:

Computation of depreciation

Block of Assets	₹
Block 1: Furniture – [Rate of depreciation - 10%]	
Put to use for more than 180 days [₹ 3,00,000@10%]	**30,000**
Block 2: Plant [Rate of depreciation - 40%]	
(a) Computer including computer software (put to use for more than 180 days) [₹ 35,000 @ 40%]	14,000
(b) Computer UPS (put to use for less than 180 days) [₹ 8,500@ 20%] **[See note below]**	1,700
(c) Computer Printer (put to use for more than 180 days) [₹ 12,500 @ 40%]	5,000
(d) Laptop (put to use for less than 180 days) [₹ 43,000 @ 20%] [See note below]	8,600
(e) Books (being annual publications or other than annual publications) (Put to use for more than 180 days) [₹ 13,000 @ 40%]	5,200
	34,500

Note - Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, the deduction on account of depreciation would be restricted to 50% of the prescribed rate. In this case, since Mr. Dhaval commenced his practice in the P.Y.2019-20 and acquired the assets during the same year, the restriction of depreciation to 50% of the prescribed rate would apply to those assets which have been put to use for less than 180 days in that year, namely, laptop and computer UPS.

Question 3

Sai Ltd. has a block of assets carrying 15% rate of depreciation, whose written down value on 01.04.2019 was ₹ 40 lacs. It purchased another asset (second-hand plant and machinery) of the same block on 01.11.2019 for ₹ 14.40 lacs and put to use on the same day. Sai Ltd. was amalgamated with Shirdi Ltd. with effect from 01 .01.2020.

You are required to compute the depreciation allowable to Sai Ltd. & Shirdi Ltd. for the previous year ended on 31.03.2020 assuming that the assets were transferred to Shirdi Ltd. at ₹ 60 lacs. Also assume that the plant and machinery were purchased by way of account payee cheque.

Answer

Statement showing computation of depreciation allowable to Sai Ltd. & Shirdi Ltd. for A.Y. 2020-21

Particulars	₹
Written down value (WDV) as on 1.4.2019	40,00,000

Addition during the year (used for less than 180 days)		14,40,000
Total		**54,40,000**
Depreciation on ₹ 40,00,000 @ 15%		6,00,000
Depreciation on ₹ 14,40,000 @ 7.5%		1,08,000
Total depreciation for the year		**7,08,000**
Apportionment between two companies:		
(a)	Amalgamating company, Sai Ltd.	
	₹ 6,00,000 × 275/366	4,50,820
	₹ 1,08,000 × 61/152	43,342
		4,94,162
(b)	Amalgamated company, Shirdi Ltd.	
	₹ 6,00,000 × 91/366	1,49,180
	₹ 1,08,000 × 91/152	64,658
		2,13,838

Notes:

(i) The aggregate deduction, in respect of depreciation allowable to the amalgamating company and amalgamated company in the case of amalgamation shall not exceed in any case, the deduction calculated at the prescribed rates as if the amalgamation had not taken place. Such deduction shall be apportioned between the amalgamating company and the amalgamated company in the ratio of the number of days for which the assets were used by them.

(ii) The price at which the assets were transferred, i.e., ₹ 60 lacs, has no implication in computing eligible depreciation.

Question 4

Lights and Power Ltd. engaged in the business of generation of power, furnishes the following particulars pertaining to P.Y. 2019-20. Compute the depreciation allowable under section 32 for A.Y. 2020-21, while computing his income under the head "Profits and gains of business or profession". The company has opted for the depreciation allowance on the basis of written down value. Assume that all the assets were purchased by way of account payee cheque.

	Particulars	(₹)
1.	Opening Written down value of Plant and Machinery (15% block) as on 01.04.2019 (Purchase value ₹ 8,00,000)	5,78,000
2.	Purchase of second hand machinery (15% block) on 29.12.2019 for business purpose	2,00,000
3.	Machinery Y (15% block) purchased and installed on 12.07.2019 for the purpose of power generation	8,00,000
4.	Acquired and installed for use a new air pollution control equipment on 31.7.2019	2,50,000
5.	New air conditioner purchased and installed in office premises on 8.9.2019	3,00,000
6.	New machinery Z (15% block) acquired and installed on 23.11.2019	3,25,000

	for the purpose of generation of power	
7.	Sale value of an old machinery X, sold during the year (Purchase value ₹ 4,80,000, WDV as on 01.04.2019 ₹ 3,46,800)	3,10,000

Answer

Computation of depreciation allowance under section 32 for the A.Y. 2020-21

Particulars	(₹)	Plant and Machinery (15%) (₹)	Plant and Machinery (40%) (₹)
Opening WDV as on 01.04.2019		5,78,000	-
Add: Plant and Machinery acquired during the year			
- Second hand machinery	2,00,000		
- Machinery Y	8,00,000		
- Air conditioner for office	3,00,000		
- Machinery Z	3,25,000	16,25,000	-
- Air pollution control equipment		-	2,50,000
		22,03,000	2,50,000
Less: Asset sold during the year		3,10,000	Nil
Written down value before charging depreciation		18,93,000	2,50,000
Normal depreciation			
40% on air pollution control equipment (₹ 2,50,000 x 40%)		-	1,00,000
Depreciation on plant and machinery put to use for less than 180 days@ 7.5% (i.e., 50% of 15%)			
- Second hand machinery (₹ 2,00,000 × 7.5%)	15,000		
- Machinery Z (₹ 3,25,000 × 7.5%)	24,375	39,375	
15% on the balance WDV being put to use for more than 180 days (₹ 13,68,000 × 15%)		2,05,200	
Additional depreciation			
- Machinery Y (₹ 8,00,000 × 20%)	1,60,000		
- Machinery Z (₹ 3,25,000 × 10%, being 50% of 20%)	32,500	1,92,500	-
- Air pollution control equipment (₹2,50,000× 20%)		-	**50,000**
Total depreciation		**4,37,075**	**1,50,000**

Notes:

(i) Power generation equipments qualify for claiming additional depreciation in respect of new plant and machinery.

(ii) Additional depreciation is not allowed in respect of second hand machinery.

(iii) No additional depreciation is allowed in respect of office appliances. Hence, no depreciation is allowed in respect of air conditioner installed in office premises.

(iv) The balance 50% additional depreciation in respect of Machinery Z of ₹ 32,500 (10% x ₹ 3,25,000) can be claimed as deduction in subsequent financial year i.e., F.Y. 2020-21.

Question 5

X Ltd. set up a manufacturing unit in Warangal in the state of Telangana on 01.06 .2019. It invested₹ 30 crore in new plant and machinery on 1.6.2019. Further, it invested ₹ 25 crore in the plant and machinery on 01.11.2019, out of which ₹ 5 crore was second hand plant and machinery. Compute the depreciation allowable under section 32. Is X Ltd. entitled for any other benefit in respect of such investment? If so, what is the benefit available?

Answer

Computation of depreciation under section 32 for X Ltd. for A.Y. 2020-21

Particulars		₹ (in crores)
Plant and machinery acquired on 01.06.2019		30.000
Plant and machinery acquired on 01.11.2019		25.000
WDV as on 31.03.2020		**55.000**
Less: Depreciation @15% on ₹ 30 crore	4.500	
Depreciation @ 7.5% (50% of 15%) on ₹ 25 crore	1.875	
Additional Depreciation@35% on ₹ 30 crore	10.500	
Additional Depreciation@17.5% (50% of 35%) on ₹ 20 crore	3.500	20.375
WDV as on 01.04.2020		**34.625**

Computation of deduction under section 32AD for X Ltd. for A.Y. 2020-21

Particulars	₹ (in crores)
Deduction under section 32AD @ 15% on ₹ 50 crore	7.50
Total benefit	**7.50**

Notes:

(1) As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 1.11.2019 is restricted to 7.5% (being 50% of 15%) and additional depreciation is restricted to 17.5% (being 50% of 35%).

(2) The balance additional depreciation of ₹ 3.5 crore, being 50% of ₹ 7 crore (35% of ₹ 20 crore) would be allowed as deduction in the A.Y.2021-22.

(3) As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, inter alia, in the business of manufacture or production of any article or thing. In th is case, since new plant and machinery acquired was installed by a manufacturing unit set up in a notified backward area in the State of Telengana, the rate of additional depreciation is 35% of actual cost of new plant and machinery. Since plant and machinery of ₹ 20 crore was put to use for less than 180 days, additional depreciation@17.5% (50% of 35%) is allowable as

deduction. However, additional depreciation shall not be allowed in respect of second hand plant and machinery of ₹ 5 crore.

Likewise, the benefit available under sections 32AD would not be allowed in respect of second hand plant and machinery.

Accordingly, additional depreciation and investment allowance under section 32AD have not been provided on ₹ 5 crore, being the actual cost of second hand plant and machinery acquired and installed in the previous year.

Question 6

A Ltd., engaged in the business of manufacturing, furnishes the following particulars for the P.Y.2019-20. Compute the deduction allowable under section 35 for A.Y.2020-21, while computing its income under the head "Profits and gains of business or profession".

	Particulars	₹
1.	Amount paid to notified approved Indian Institute of Science, Bangalore, for scientific research	1,00,000
2.	Amount paid to IIT, Delhi for an approved scientific research programme	2,50,000
3.	Amount paid to X Ltd., a company registered in India which has as its main object scientific research and development, as is approved by the prescribed authority	4,00,000
4.	Expenditure incurred on in-house research and development facility as approved by the prescribed authority	
	(a) Revenue expenditure on scientific research	3,00,000
	(b) Capital expenditure (including cost of acquisition of land ₹ 5,00,000) on scientific research	7,50,000

Answer

Computation of deduction under section 35 for the A.Y.2020-21

Particulars	₹	Section	% of deduction	Deduction (₹)
Payment for scientific research				
Indian Institute of Science	1,00,000	35(1)(ii)	150%	1,50,000
IIT, Delhi	2,50,000	35(2AA)	150%	3,75,000
X Ltd.	4,00,000	35(1)(iia)	100%	4,00,000
Expenditure incurred on in-house research and development facility				
Revenue expenditure	3,00,000	35(2AB))	150%	4,50,000
Capital expenditure (excluding cost of acquisition of land ₹ 5,00,000)	2,50,000	35(2AB)	150%	3,75,000
Deduction allowable under section 35				**17,50,000**

Question 7

Mr. A commenced operations of the businesses of setting up a warehousing facility for storage of food grains, sugar and edible oil on 1.4.2019. He incurred capital expenditure of ₹ 80 lakh, ₹ 60 lakh and ₹ 50 lakh, respectively, on purchase of land and building during the period January, 2019 to March, 2019 exclusively for the above businesses, and capitalized the same in its books of account as on 1st April, 2019. The cost of land included in the above figures are ₹ 50 lakh, ₹ 40 lakh and ₹ 30 lakh, respectively. Further, during the P.Y.2019-20, he incurred capital expenditure of ₹ 20 lakh, ₹ 15 lakh & ₹ 10 lakh, respectively, for extension/ reconstruction of the building purchased and used exclusively for the above businesses.

The profits from the business of setting up a warehousing facility for storage of food grains, sugar and edible oil (before claiming deduction under section 35AD and section 32) for the A.Y. 2020-21 is ₹ 16 lakhs, ₹ 14 lakhs and ₹ 31 lakhs, respectively.

Compute the income under the head "Profits and gains of business or profession" for the A.Y.2020-21 and the loss to be carried forward, assuming that Mr. A has fulfilled a ll the conditions specified for claim of deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading "C. – Deductions in respect of certain incomes". Assume in respect of expenditure incurred, the payments are made by account payee cheque or use of ECS through bank account.

Answer

Computation of profits and gains of business or profession for A.Y. 2020-21

Particulars	₹ (in lakhs)
Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)	31
Less: Depreciation under section 32	
10% of ₹ 30 lakh, being (₹ 50 lakh – ₹ 30 lakh + ₹ 10 lakh)	3
Income chargeable under "Profits and gains from business or profession"	**28**

Computation of income/loss from specified business under section 35AD

	Particulars	Food Grains	Sugar	Total
		₹ (in lakhs)		
(A)	Profits from the specified business of setting up a warehousing facility (before providing deduction under section 35AD)	16	14	30
	Less: **Deduction under section 35AD**			
(B)	Capital expenditure incurred prior to 1.4.2019 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2019 (excluding the expenditure incurred on acquisition of land) = ₹ 30 lakh (₹ 80 lakh – ₹ 50 lakh) and ₹ 20 lakh (₹ 60 lakh – ₹ 40 lakh)	30	20	50
(C)	Capital expenditure incurred during the P.Y.2019-20	20	15	35
(D)	**Total capital expenditure (B + C)**	**50**	**35**	**85**

(E)	**Deduction under section 35AD**			
	100% of capital expenditure (food grains/sugar)	50	35	85
	Total deduction u/s 35AD for A.Y.2020-21	**50**	**35**	**85**
(F)	**Loss from the specified business of setting up and operating a warehousing facility (after providing for deduction under section 35AD) to be carried forward as per section 73A (A-E)**	**(34)**	**(21)**	**(55)**

Notes:

(i) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2020- 21 in respect of specified business of setting up and operating a warehousing facility for storage of sugar and setting up and operating a warehousing facility for storage of agricultural produce where operations are commenced on or after 01.04.2012 or on or after 01.04.2009, respectively.

(ii) However, since setting up and operating a warehousing facility for storage of edible oils is not a specified business, Mr. A is not eligible for deduction under section 35AD in respect of capital expenditure incurred in respect of such business.

(iii) Mr. A can, however, claim depreciation@10% under section 32 in respect of the capital expenditure incurred on buildings. It is presumed that the buildings were put to use for more than 180 days during the P.Y. 2019-20.

(iv) Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of ₹ 55 lakh from the specified businesses of setting up and operating a warehousing facility for storage of food grains and sugar cannot be set-off against the profits of ₹ 28 lakh from the business of setting and operating a warehousing facility for storage of edible oils, since the same is not a specified business. Such loss can, however, be carried forward indefinitely for set-off against profits of the same or any other specified business.

Question 8

XYZ Ltd. commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on 1.4.2019. The company incurred capital expenditure of ₹ 50 lakh during the period January, 2019 to March, 2019 exclusively for the above business, and capitalized the same in his books of account as on 1st April, 2019. Further, during the P.Y. 2019-20, it incurred capital expenditure of ₹ 2 crore (out of which ₹ 1.50 crore was for acquisition of land) exclusively for the above business.

Compute the income under the head "Profits and gains of business or profession" for the A.Y.2020-21, assuming that XYZ Ltd. has fulfilled all the conditions specified for claim of deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading "C. – Deductions in respect of certain incomes".

The profits from the business of running this hotel (before claiming deduction under section 35AD) for the A.Y.2020-21 is ₹ 25 lakhs. Assume that the company also has another existing business of running a four-star hotel in Coimbatore, which commenced operations fifteen years back, the profits from which are ₹ 120 lakhs for the A.Y.2020-21. Also, assume that expenditure incurred during the previous year 2019-20 were paid by account payee cheque or use of ECS through bank account.

Answer

Computation of profits and gains of business or profession for A.Y. 2020-21

Particulars		₹
Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)		25 lakh
Less: **Deduction under section 35AD**		
Capital expenditure incurred during the P.Y.2019-20 (excluding the expenditure incurred on acquisition of land) = ₹ 200 lakh – ₹ 150 lakh	50 lakh	
Capital expenditure incurred prior to 1.4.2019 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2019	50 lakh	
Total deduction under section 35AD for A.Y.2020-21		100 lakh
Loss from the specified business of new hotel in Madurai		**(75 lakh)**
Profit from the existing business of running a hotel in Coimbatore		120 lakh
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A		**45 lakh**

Question 9

ABC Ltd. is a company having two units – Unit A carries on specified business of setting up and operating a warehousing facility for storage of sugar; Unit B carries on non-specified business of operating a warehousing facility for storage of edible oil.

Unit A commenced operations on 1.4.2018 and it claimed deduction of ₹ 100 lacs incurred on purchase of two buildings for ₹ 50 lacs each (for operating a warehousing facility for storage of sugar) under section 35AD for A.Y. 2019-20. However, in February, 2020, Unit A transferred one of its buildings to Unit B.

Examine the tax implications of such transfer in the hands of ABC Ltd.

Answer

Since the capital asset, in respect of which deduction of ₹ 50 lacs was claimed under section 35AD, has been transferred by Unit A carrying on specified business to Unit B carrying on non-specified business in the P.Y.2019-20, the deeming provision under section 35AD(7B) is attracted during the A.Y. 2020-21.

Particulars	₹
Deduction allowed under section 35AD for A.Y.2019-20	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2019-20 [10% of ₹ 50 lacs]	5,00,000
Deemed income under section 35AD(7B)	**45,00,000**

ABC Ltd., however, by virtue of proviso to Explanation 13 to section 43(1), can claim depreciation under section 32 on the building in Unit B for A.Y. 2020-21. For the purpose of claiming depreciation on building in Unit B, the actual cost of the building would be:

Particulars	₹

Actual cost to the assessee	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2019-20 [10% of ₹ 50 lacs]	5,00,000
Actual cost in the hands of ABC Ltd. in respect of building in Unit B	**45,00,000**

Question 10

X Ltd. contributes 20% of basic salary to the account of each employee under a pension scheme referred to in section 80CCD. Dearness Allowance is 40% of basic salary and it forms part of pay of the employees.

Compute the amount of deduction allowable under section 36(1)(iva), if the basic salary of the employees aggregate to ₹ 10 lakh. Would disallowance under section 40A(9) be attracted, and if so, to what extent?

Answer

Computation of deduction u/s 36(1)(iva) and disallowance u/s 40A(9)

Particulars	₹
Basic Salary	10,00,000
Dearness Allowance@40% of basic salary [DA forms part of pay]	4,00,000
Salary for the purpose of section 36(1)(iva) (Basic Salary + DA)	**14,00,000**
Actual contribution (20% of basic salary i.e., 20% of ₹10 lakh)	**2,00,000**
Less: Permissible deduction under section 36(1)(iva) (10% of basic salary plus dearness pay = 10% of ₹ 14,00,000 = ₹ 1,40,000)	**1,40,000**
Excess contribution disallowed under section 40A(9)	**60,000**

Question 11

The following are the particulars in respect of a scheduled bank incorporated in India -

	Particulars	₹ in lakh
(i)	Provision for bad and doubtful debts under section 36(1)(viia) upto A.Y.2019-20	100
(ii)	Gross Total Income of A.Y.2020-21 [before deduction under section 36(1)(viia)]	800
(iii)	Aggregate average advances made by rural branches of the bank	300
(iv)	Bad debts written off (for the first time) in the books of account (in respect of urban advances only) during the previous year 2019-20	210

Compute the deduction allowable under section 36(1)(vii) for the A.Y.2020-21.

Answer

Computation of deduction allowable under section 36(1)(vii) for the A.Y.2020-21

Particulars	₹ in lakh	
Bad debts written off (for the first time) in the books of account		210
Less: Credit balance in the "Provision for bad and doubtful debts" under section 36(1)(viia) as on 31.3.2020		
(i) Provision for bad and doubtful debts u/s 36(1)(viia) upto A.Y.2019-20	100	

(ii)	Current year provision for bad and doubtful debts u/s 36(1)(viia) [8.5% of ₹ 800 lakhs + 10% of ₹ 300 lakhs]	98	198
Deduction under section 36(1)(vii) in respect of bad debts written off for A.Y.2020-21			**12**

Question 12

Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31.03.2020 is ₹ 35,25,890 after debiting the following items:

S.No.	Particulars	₹
1.	Purchase price of raw material used for the purpose of in-house research and development	11,80,000
2.	Purchase price of asset used for in-house research and development	
	(a) Land	5,00,000
	(b) Building	3,00,000
3.	Expenditure incurred on notified agricultural extension project	25,50,000
4.	Expenditure on notified skill development project:	
	(a) Purchase of land	40,00,000
	(b) Expenditure on training for skill development	32,50,000
5.	Expenditure incurred on advertisement in the souvenir published by a political party	75,000

Compute the income under the head "Profits and gains of business or profession" for the A.Y. 2020-21 of Isac Ltd.

Answer

Computation of income under the head "Profits and gains of business or profession" for the A.Y.2020-21

Particulars		₹	₹
Net profit as per profit and loss account			35,25,890
Add:	**Items debited to profit and loss account, but to be disallowed**		
	Purchase price of Land used in in-house research and development - being capital expenditure not allowable as deduction under section 35	5,00,000	
	Purchase price of building used in in-house research and development - being capital expenditure, 100% of which is allowable as deduction u/s 35(1)(iv) read with section 35(2)	-	
	Expenditure incurred on notified agricultural extension project (to be treated separately)	**25,50,000**	
	Expenditure incurred on notified skill development project		
	- Purchase of land - being capital expenditure not qualifying for deduction under section 35CCD	**40,00,000**	

	Expenditure incurred on notified skill development project	**32,50,000**	
	- Expenditure on training for skill development (to be treated separately)		
	Expenditure incurred on advertisement in the souvenir published by a political party not allowed as deduction as per section 37(2B)	**75,000**	1,03,75,000
			1,39,00,890
Less:	Purchase price of raw material used for in-house research and development qualifies for 150% deduction under section 35(2AB). Since, it is already debited to profit and loss account balance 50% is allowed.	**5,90,000**	
Less:	Expenditure incurred on notified agricultural extension project qualifies for 150% deduction under section 35CCC.	**38,25,000**	
Less:	Expenditure incurred on training for skill development in a notified skill development project qualifies for 150% deduction under section 35CCD.	**48,75,000**	92,90,000
	Profit and gains from business		**46,10,890**

Note: The expenditure incurred on advertisement in the souvenir published by a political party is disallowed as per section 37(2B) while computing income under the head "Profit and Gains of Business or Profession" but the same would be allowed as deduction under section 80GGB from the gross total income of the company.

Question 13

Delta Ltd. credited the following amounts to the account of resident payees in the month of March, 2020 without deduction of tax at source. What would be the consequence of non-deduction of tax at source by Delta Ltd. on these amounts during the financial year 2019-20, assuming that the resident payees in all the cases mentioned below, have not paid the tax, if any, which was required to be deducted by Delta Ltd.?

	Particulars	Amount (₹)
(1)	Salary to its employees (credited and paid in March, 2020)	12,00,000
(2)	Directors' remuneration (credited in March, 2020 and paid in April, 2020)	28,000

Would your answer change if Delta Ltd. has deducted tax on directors' remuneration in April, 2020 at the time of payment and remitted the same in July, 2020?

Answer

Non-deduction of tax at source on any sum payable to a resident on which tax is deductible at source as per the provisions of Chapter XVII-B would attract disallowance under section 40(a)(ia).

Therefore, non-deduction of tax at source on any sum paid by way of salary on which tax is deductible under section 192 or any sum credited or paid by way of directors' remuneration on which tax is deductible under section 194J, would attract disallowance@30% under section 40(a)(ia). Whereas in case of salary, tax has to be deducted under section 192 at the time of payment, in case of directors' remuneration, tax has to be deducted at the time of credit of such

sum to the account of the payee or at the time of payment, whichever is earlier. Therefore, in both the cases i.e., salary and directors' remuneration, tax is deductible in the P.Y.2019-20, since salary was paid in that year and directors' remuneration was credited in that year. Therefore, the amount to be disallowed under section 40(a)(ia) while computing business income for A.Y.2020-21 is as follows –

	Particulars	Amount paid in ₹	Disallowance u/s 40(a)(ia) @ 30% (₹)
(1)	Salary [tax is deductible under section 192]	12,00,000	3,60,000
(2)	Directors' remuneration [tax is deductible under section 194J without any threshold limit]	28,000	8,400
Disallowance under section 40(a)(ia)			**3,68,400**

If the tax is deducted on directors' remuneration in the next year i.e., P.Y.2020-21 at the time of payment and remitted to the Government, the amount of ₹ 8,400 would be allowed as deduction while computing the business income of A.Y.2021-22.

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such **payee** –

(i) has furnished his return of income under section 139;
(ii) has taken into account such sum for computing income in such return of income; and
(iii) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed,

it would be deemed that the assessee has deducted and paid the tax on such sum.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the **payee.**

Since the date of furnishing the return of income by the payee is taken to be the date on which the payer has deducted tax at source and paid the same, 30% of such expenditure/payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(ia) in the year in which the said expenditure is incurred. However, 30% of such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the payee, since tax is deemed to have been deducted and paid by the payer in that year.

Question 14

During the financial year 2019-20, the following payments/expenditure were made/incurred by Mr. Yuvan Raja, a resident individual (whose turnover during the year ended 31.3.2019 was ₹ 99 lacs):

(i) Interest of ₹ 45,000 was paid to Rehman & Co., a resident partnership firm, without deduction of tax at source;
(ii) ₹ 3,00,000 was paid as salary to a resident individual without deduction of tax at source;
(iii) Commission of ₹ 16,000 was paid to Mr. Vidyasagar on 2.7.2019 without deduction of tax at source.

Briefly discuss whether any disallowance arises under the provisions of section 40(a)(ia) of the Income-tax Act, 1961 assuming that the payees in all the cases mentioned above, have not paid the tax, if any, which was required to be deducted by Mr. Raja?

Answer

Disallowance under section 40(a)(ia) of the Income-tax Act, 1961 is attracted where the assessee fails to deduct tax at source as is required under the Act, or having deducted tax at source, fails to remit the same to the credit of the Central Government within the stipulated time limit.

(i) The obligation to deduct tax at source from interest paid to a resident arises under section 194A in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2018-19 exceeds ₹ 100 lakhs. Thus, in present case, since the turnover of the assessee is less than ₹ 100 lakhs, he is not liable to deduct tax at source. Hence, disallowance under section 40(a)(ia) is not attracted in this case.

(ii) The disallowance of 30% of the sums payable under section 40(a)(ia) would be attracted in respect of all sums on which tax is deductible under Chapter XVII-B. Section 192, which requires deduction of tax at source from salary paid, is covered under Chapter XVII -B. The obligation to deduct tax at source under section 192 arises, in the hands all assessee-employer even if the turnover amount does not exceed ₹100 lacs in the immediately preceding previous year.

Therefore, in the present case, the disallowance under section 40(a)(ia) is attracted for failure to deduct tax at source under section 192 from salary payment. However, only 30% of the amount of salary paid without deduction of tax at source would be disallowed.

(iii) The obligation to deduct tax at source under section 194-H from commission paid in excess of ₹ 15,000 to a resident arises in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2018-19 exceeds ₹ 100 lakhs. Thus, in present case, since the turnover of the assessee is less than ₹ 100 lakhs, he is not liable to deduct tax at source. Mr. Raja is not required to deduct tax at source u/s 194M also since the aggregate of such commission to Mr. Vidyasagar does not exceed ₹ 50 lakh during the P.Y. 2019-20. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

Question 15

A firm assessed as such has paid ₹ 7,50,000 as remuneration to its partners for the P.Y.2019-20, in accordance with its partnership deed, and it has a book profit of ₹ 10 lakh. What is the remuneration allowable as deduction?

Answer

The allowable remuneration calculated as per the limits specified in section 40(b)(v) would be –

Particulars	₹
On first ₹ 3 lakh of book profit [₹ 3,00,000 × 90%]	2,70,000
On balance ₹ 7 lakh of book profit [₹ 7,00,000 × 60%]	4,20,000
	6,90,000

The excess amount of ₹ 60,000 (i.e., ₹ 7,50,000 – ₹ 6,90,000) would be disallowed as per section 40(b)(v).

Question 16

Rao & Jain, a partnership firm consisting of two partners, reports a net profit of ₹ 7,00,000 before deduction of the following items:

(1) Salary of ₹ 20,000 each per month payable to two working partners of the firm (as authorized by the deed of partnership).

(2) Depreciation on plant and machinery under section 32 (computed) ₹ 1,50,000.

(3) Interest on capital at 15% per annum (as per the deed of partnership). The amount of capital eligible for interest ₹ 5,00,000.

Compute:

(i) Book-profit of the firm under section 40(b) of the Income-tax Act, 1961.

(ii) Allowable working partner salary for the assessment year 2020-21 as per section 40(b).

Answer

(i) As per Explanation 3 to section 40(b), "book profit" shall mean the net profit as per the profit and loss account for the relevant previous year computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to the partners of the firm if the same has been already deducted while computing the net profit.

In the present case, the net profit given is before deduction of depreciation on plant and machinery, interest on capital of partners and salary to the working partners. Therefore, the book profit shall be as follows:

Computation of Book Profit of the firm under section 40(b)

Particulars		₹	₹
Net Profit (before deduction of depreciation, salary and interest)			7,00,000
Less:	Depreciation under section 32	1,50,000	
	Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (₹ 5,00,000 × 12%)	60,000	2,10,000
Book Profit			**4,90,000**

(ii) Salary actually paid to working partners = ₹ 20,000 × 2 × 12 = ₹ 4,80,000.

As per the provisions of section 40(b)(v), the salary paid to the working partners is allowed subject to the following limits –

On the first ₹ 3,00,000 of book profit or in case of loss	₹ 1,50,000 or 90% of book profit, whichever is more
On the balance of book profit	60% of the balance book profit

Therefore, the maximum allowable working partners' salary for the A.Y. 2020-21 in this case would be:

Particulars	₹
On the first ₹ 3,00,000 of book profit [(₹ 1,50,000 or 90% of ₹ 3,00,000) whichever is more]	2,70,000
On the balance of book profit [60% of (₹ 4,90,000 - ₹ 3,00,000)]	1,14,000
Maximum allowable partners' salary	**3,84,000**

Hence, allowable working partners' salary for the A.Y. 2020-21 as per the provisions of section 40(b)(v) is ₹ 3,84,000.

Question 17

Hari, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Andhra Pradesh State Financial Corporation (APSFC) and Indian Bank and has not paid interest as detailed hereunder:

		₹
(i)	Andhra Pradesh State Financial Corporation (P.Y. 2018-19 & 2019-20)	15,00,000
(ii)	Indian Bank (P.Y. 2019-20)	30,00,000
		45,00,000

Both APSFC and Indian Bank, while restructuring the loan facilities of Hari during the year 2019-20, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2020, Hari paid 5 installments to APSFC and 3 installments to Indian Bank.

Hari claimed the entire interest of ₹ 45,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities. Discuss whether his claim is valid and if not what is the amount of interest, if any, allowable.

Answer

According to section 43B, any interest payable on the term loans to specified financial institutions and any interest payable on any loans and advances to scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee. Where there is default in the payment of interest by the assessee, such unpaid interest may be converted into loan. Such conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest so converted as loan shall be allowed as deduction only in the year in which the converted loan is actually paid.

In the given case of Hari, the unpaid interest of ₹ 15,00,000 due to APSFC and of ₹ 30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of ₹ 45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y.20 20-21 shall be calculated as follows:

	Interest outstanding (₹)	**Number of Instalments**	**Amount per instalment (₹)**	**Instalments paid**	**Interest allowable (₹)**
APSFC	15 lakh	60	25,000	5	1,25,000
Indian Bank	30 lakh	60	50,000	3	1,50,000
Total amount eligible for deduction					**2,75,000**

Question 18

Vinod is a person carrying on profession as film artist. His gross receipts from profession are as under:

	₹
Financial year 2016-17	1,15,000
Financial year 2017-18	1,80,000
Financial year 2018-19	2,10,000

What is his obligation regarding maintenance of books of accounts for Assessment Year 2020-21 under section 44AA of Income-tax Act, 1961?

Answer

Section 44AA(1) requires every person carrying on any profession, notified by the Board in the Official Gazette (in addition to the professions already specified therein), to maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act, 1961.

As per Rule 6F, a person carrying on a notified profession shall be required to maintain specified books of accounts, only if:

(i) his gross receipts in all the three years immediately preceding the relevant previous year has exceeded ₹ 1,50,000; or

(ii) it is a new profession which is setup in the relevant previous year, it is likely to exceed ₹ 1,50,000 in that previous year.

In the present case, Vinod is a person carrying on profession as film artist, which is a notified profession. Since his gross receipts have not exceeded ₹ 1,50,000 in financial year 2016-17, the requirement under section 44AA to compulsorily maintain the prescribed books of account is not applicable to him for A.Y. 2020-21.

Mr. Vinod, however, required to maintain such books of accounts as would enable t he Assessing Officer to compute his total income.

Question 19

Mr. Praveen engaged in retail trade, reports a turnover of ₹ 1,98,50,000 for the financial year 2019-20. His income from the said business as per books of account is ₹ 11,20,000 computed as per the provisions of Chapter IV-D "Profits and gains from business or Profession" of the Income-tax Act, 1961. All transactions are carried out by way of A/c payee cheque/ECS through bank A/c. Retail trade is the only source of income for Mr. Praveen. A.Y. 2019-20 was the first year for which he declared his business income in accordance with the provisions of presumptive taxation under section 44AD.

(i) Is Mr. Praveen eligible to opt for presumptive taxation scheme in respect of his income from retail trade for the assessment year 2020-21?
(ii) If so, determine his income from retail trade as per the applicable presumptive provision.
(iii) In case Mr. Praveen does not opt for presumptive taxation of income from retail trade, what are his obligations under the Income-tax Act, 1961?
(iv) What is the due date for filing his return of income under both the options?

Answer

(i) Yes. Since his total turnover for the F.Y.2019-20 is below ₹ 200 lakhs, he is eligible to opt for presumptive taxation scheme under section 44AD in respect of his retail trade business.

(ii) His income from retail trade, applying the presumptive tax provisions under section 44AD, would be ₹ 11,91,000, being 6% of ₹ 1,98,50,000.

(iii) Mr. Praveen had declared profit for the previous year 2018-19 in accordance with the presumptive provisions and if he does not opt for presumptive provisions for any of the five consecutive assessment years i.e., A.Y. 2020-21 to A.Y. 2024-25, he would not be eligible to claim the benefit of presumptive taxation for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance the presumptive provisions i.e., if he does not opt for presumptive taxation in say P.Y. 2019-20, then he would not be eligible to claim the benefit of presumptive taxation for

A.Y. 2021-22 to A.Y. 2025-26.

Consequently, Mr. Praveen is required to maintain the books of accounts and get them audited under section 44AB, since his income exceeds the basic exemption limit.

(iv) In case he opts for the presumptive taxation scheme under section 44AD, the due date would be 31st July, 2020.

In case he does not opt for presumptive taxation scheme, he is required to get his books of account audited, in which case the due date for filing of return of income would be 30 th September, 2020.

Question 20

Mr. X commenced the business of operating goods vehicles on 1.4.2019. He purchased the following vehicles during the P.Y.2019-20. Compute his income under section 44AE for A.Y.2020-21.

	Gross Vehicle Weight (in kilograms)	Number	Date of purchase
(1)	7,000	2	10.04.2019
(2)	6,500	1	15.03.2020
(3)	10,000	3	16.07.2019
(4)	11,000	1	02.01.2020
(5)	15,000	2	29.08.2019
(6)	15,000	1	23.02.2020

Would your answer change if the two goods vehicles purchased in April, 2019 were put to use only in July, 2019?

Answer

Since Mr. X does not own more than 10 vehicles at any time during the previous year 2019-20, he is eligible to opt for presumptive taxation scheme under section 44AE. ₹ 1,000 per ton of gross vehicle weight or unladen weight per month or part of the month for each heavy goods vehicle and ₹ 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by him would be deemed as his profits and gains from such goods carriage.

Heavy goods vehicle means any goods carriage, the gross vehicle weight of which exceeds 12,000 kg.

(1)	(2)	(3)	(4)
Number of Vehicles	**Date of purchase**	**No. of months for which vehicle is owned**	**No. of months × No. of vehicles [(1) × (3)]**
Heavy goods vehicle			
2	29.08.2019	8	16
1	23.02.2020	2	2
			18
Goods vehicle other than heavy goods vehicle			
2	10.4.2019	12	24
1	15.3.2020	1	1
3	16.7.2019	9	27
1	2.1.2020	3	3

	55

The presumptive income of Mr. X under section 44AE for A.Y.2020-21 would be -

₹ 6,82,500, i.e., 55 × ₹ 7,500, being for other than heavy goods vehicle + 18 x ₹ 1,000 x 15 ton being for heavy goods vehicle.

The answer would remain the same even if the two vehicles purchased in April, 2019 were put to use only in July, 2019, since the presumptive income has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.

Question 21

Alpha Co-operative Bank amalgamated with Beta Co-operative Bank on 1.12.2019. The depreciation for the year ended 31.3.2020 calculated as per Income-tax Rules, 1962, allowable to Alpha Co-operative Bank had the amalgamation had not taken place amounts to ₹ 2,40,000. Compute the deduction on account of depreciation allowable in the hands of Alpha Co-operative Bank and Beta Co-operative Bank for A.Y. 2020-21.

Answer

(i) The amount of deduction allowable to the amalgamating co-operative bank (i.e. Alpha Co-operative bank, in this case) under section 32 has to be determined in accordance with the following formula – A*B/C

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.

B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e., 1.4.2019, in this case) and ending on the day immediately preceding the date of business reorganization (i.e., 30.11.2019, in this case); and

C= the total number of days in the financial year in which the business reorganisation has taken place (i.e., 366 days).

(ii) The amount of deduction allowable to the amalgamated co-operative bank (i.e. Beta Co-operative bank, in this case) under section 32 has to be determined in accordance with the formula – A*B/C

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.

B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.12.2019, in this case) and ending on the last day of the financial year (i.e. 31.3.2020); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 366 days).

(iii) In this case, the deduction that would have been allowable under section 32 to Alpha co - operative bank had the business reorganization had not taken place is ₹ 2,40,000 and the business re-organisation took place on 1.12.2019. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be ₹1,60,000 i.e., ₹ 2,40,000 x 244/366. The deduction allowable to Beta co-operative bank would be ₹ 80,000 i.e., ₹ 2,40,000 x 122/366.

Question 22

Miss Vivitha, a resident and ordinarily resident in India, has derived the following income from various operations (relating to plantations and estates owned by her) during the year ended 31-3-2020:

S. No.	Particulars	₹
(i)	Income from sale of centrifuged latex processed from rubber plants grown in Darjeeling.	3,00,000
(ii)	Income from sale of coffee grown and cured in Yercaud, Tamil Nadu.	1,00,000
(iii)	Income from sale of coffee grown, cured, roasted and grounded, in Colombo. Sale consideration was received at Chennai.	2,50,000
(iv)	Income from sale of tea grown and manufactured in Shimla.	4,00,000
(v)	Income from sapling and seedling grown in a nursery at Cochin. Basic operations were not carried out by her on land.	80,000

You are required to compute the business income and agricultural income of Miss Vivitha for the assessment year 2020-21.

Answer

Computation of business income and agricultural income of Ms. Vivitha for the A.Y.2020-21

Sr. No.	Source of income	Gross (₹)	Business income		Agricultural income
			%	₹	₹
(i)	Sale of centrifuged latex from rubber plants grown in India.	3,00,000	35%	1,05,000	**1,95,000**
(ii)	Sale of coffee grown and cured in India.	1,00,000	25%	25,000	**75,000**
(iii)	Sale of coffee grown, cured, roasted and grounded outside India. **(See Note 1 below)**	2,50,000	100%	2,50,000	**-**
(iv)	Sale of tea grown and manufactured in India	4,00,000	40%	1,60,000	**2,40,000**
(v)	Saplings and seedlings grown in nursery in India **(See Note 2 below)**	80,000		Nil	**80,000**
	Total			**5,40,000**	**5,90,000**

Notes:

1. Where income is derived from sale of coffee grown, cured, roasted and grounded by the seller in India, 40% of such income is taken as business income and the balance as agricultural income. However, in this question, these operations are done in Colombo, Sri lanka. Hence, there is no question of such apportionment and the whole income is taxable as business income. Receipt of sale proceeds in India does not make this agricultural income. In the case of an assessee, being a resident and ordinarily resident, the income arising outside India is also chargeable to tax.
2. Explanation 3 to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income whether or not the basic operations were carried out on land.

Question 23

Examine critically the following cases in the context of provisions contained in the Income-tax Act, 1961 relevant for Assessment Year 2020-21. Support the answers with relevant case laws and workings.

(a) Mr. Janak is proprietor of M/s. Yash Texnit which is engaged in garment manufacturing business. The entire block of Plant & Machinery chargeable to depreciation @ 15%, has 20 different machinery items as at 31-03-2020. One of the machineries used for packing had become obsolete and was discarded by Mr. Janak in July' 19.

Assessee filed its return for A.Y. 2020-21 claiming total depreciation of ₹ 40 lacs which includes ₹ 4 lacs being the depreciation claimed on the machinery item discarded by Mr. Janak. The A.O. disallowed the claim of depreciation of ₹ 4 lacs during the course of scrutiny assessment. Comment on the validity of action taken by A.O.

(b) X. Ltd. issued debentures in the previous year 2019-20, which were to be matured at the end of 5 years. The debenture holder was given an option of one time upfront payment of ₹ 60 per debenture on account of interest which was to be immediately paid by the company. As per the option exercised by the debenture holders, company paid interest upfront to them in the first year itself and the same was claimed as deduction in the return of the company. But in the accounts, the interest expenditure was shown as deferred expenditure to be written off over a period of 5 years. During the course of assessment, the Assessing Officer spread the upfront interest paid over a period of five year term of debentures and allowed only one-fifth of the amount in the previous year 2019-20. Examine the correctness of the action of Assessing Officer.

Answer

(a) The issue under consideration is whether disallowance of depreciation made by the Assessing Officer with regard to the discarded asset, in arriving at the written down value of the block of assets, is justified.

One of the conditions for claim of depreciation under section 32 is that the eligible asset must have been put to use for the purpose of business or profession.

The other aspect to considered is whether merely discarding an obsolete machinery, which is physically available, will attract the expression "moneys payable" appearing in section 43(6), so as to deduct its value from the written down value of the block.

The facts in the present case are similar to facts in the case of CIT v. Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297, wherein the Delhi High Court observed that the expression "used for the purposes of the business" in section 32 when used with respect to discarded machinery would mean the use in the business, not only in the relevant financial year/previous year, but also in the earlier financial years.

The discarded machinery may not be actually used in the relevant previous year but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year. Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it was used in the earlier previous years for the business.

For the purpose of section 43(6), "moneys payable" means the sale price, in case of sale, or the insurance, salvage or compensation moneys payable in respect of the asset. In this case, the machinery has not been sold as machinery or scrap or disposed off, and it continues to exist. Hence, there is no "moneys payable" in this case, which alone is deductible while computing the WDV of the block to which it belongs.

Applying the rationale of the above case, the action of the Assessing Officer in disallowing ₹ 4

lakhs, being the depreciation claim attributable to discarded machinery, on the ground that the same was not put to use in the relevant previous year, is invalid, since the said machinery was put to use in the earlier previous years.

(b) The issue under consideration is whether, in a case where debentures are issued with maturity at the end of five years, and the debenture holders are given an option of upfront payment of interest in the first year itself, can the entire upfront interest paid, be claimed as deduction by the company in the first year or should the same be deferred over a period of five years; and would the treatment of such interest as deferred revenue expenditure in the books of account have any impact on the tax treatment.

The facts of the case are similar to the facts in Taparia Tools Ltd. v. JCIT (2015) 372 ITR 605, wherein the above issue came up before the Supreme Court. In that case, it was observed that under section 36(1)(iii), the amount of interest paid in respect of capital borrowed for the purposes of business or profession, is allowable as deduction.

The moment the option for upfront payment was exercised by the subscriber, the liability of X Ltd. to make the payment in that year had arisen. Not only had the liability arisen in the previous year in question, it was even quantified and discharged as well in that very year.

As per the rationale of the Supreme Court ruling in Taparia Tools Ltd.'s case, when the deduction of entire upfront payment of interest is allowable as per the Income-tax Act, 1961, the fact that a different treatment was given in the books of account could not be a factor which would bar the company from claiming the entire expenditure as a deduction.

Accordingly, the action of the Assessing Officer in spreading the upfront interest paid over the five year term of debentures and restricting the deduction in the P.Y.2019-20 to one-fifth of the upfront interest paid is not correct. The company is eligible to claim the entire amount of interest paid upfront as deduction under section 36(1)(iii) in the P.Y.2019-20.

Question 24

Compute the quantum of depreciation available under section 32 of the Income-tax Act, 1961 in respect of the following items of Plant and Machinery purchased by PQR Textile Ltd., by paying through account payee cheque, which is engaged in the manufacture of textile fabrics, for the year ended 31-3-2020:

	(₹ In crores)
New machinery installed on 1-5-2019	84
New Windmill purchased and installed on 18-6-2019.	22
Lorries for transporting goods to sales depots (purchased and put to use in July, 2019)	3
Items purchased after 30th November 2019:	
Fork-lift-trucks, used inside factory	4
Computers installed in office premises	1
Computers installed in factory	2
New imported machinery	12

The new imported machinery arrived at Chennai port on 30-03-2020 and was installed on 3-4-2020. All other items were installed during the year ended 31-3-2020.
The company was newly started during the year.
Also, compute the WDV of the various blocks of assets as on 1.4.2020.

Answer

Computation of depreciation allowance under section 32 for the A.Y. 2020-21

Particulars	Normal Depreciation [u/s 32(1)(ii)]	Additional Depreciation [u/s 32(1)(iia)]
	(₹ in crores)	
(A) Plant and Machinery (15% block) (Put to use for 180 days or more)		
- New machinery installed on 01.05.2019	84.00	84.00
- Lorries for transporting goods to depots	3.00	-
	87.00	84.00
Normal Depreciation @15% & additional deprecation @20%	**13.05**	**16.80**
(B) Plant and Machinery (15% block) (Put to use for less than 180 days – hence, depreciation is restricted to 7.5%, being 50% of 15%)		
- Fork-lift trucks, used inside a factory	4.00	4.00
Normal Depreciation@ 7.5% & additional depreciation @10%	**0.30**	**0.40**
(C) Plant and Machinery (40% block) (Put to use for less than 180 days, hence depreciation restricted to 20%, i.e., 50% of 40%)		
- Computers installed in office premises	1.00	-
- Computers installed in factory	2.00	2.00
	3.00	**2.00**
Normal depreciation @20% & additional depreciation@10%	**0.60**	**0.20**
(D) Plant and Machinery (40% block) (Put to use for 180 days or more) (See Note 1)		
- New windmill purchased and installed on 18.06.2019	22.00	22.00
Normal Depreciation@ 40% & additional depreciation @ 20%	**8.80**	**4.40**
Total depreciation and additional depreciation		
- Plant and Machinery (15% block) (A +B)	13.35	17.20
- Plant and Machinery (40% block) (C + D)	9.40	4.60
Depreciation available under section 32 = ₹ 44.55 crores		

Computation of Written Down Value (WDV) as on 01.04.2020

Particulars	Plant & Machinery	
	15%	40%
	(₹ in crores)	
WDV as on 01.04.2019 (The company was started during the year – as given in question)	Nil	Nil
Add: Plant and Machinery acquired during the year		

- New Machinery installed on 01.05.2019	84.00		
- Lorries for transporting goods to sales depots	3.00		
- Fork-lift trucks, used inside factory	4.00		
- New imported machinery	12.00	103.00	-
- New Windmill purchased and installed on 18.6.2019		-	22.00
- Computers installed in office premises		-	1.00
- Computers installed in factory		-	2.00
		103.00	**25.00**
Less: Asset sold during the year		Nil	Nil
WDV as on 31.3.2020 (before charging depreciation)		**103.00**	**25.00**
Less: Depreciation for the P.Y.2019-20			
- Normal depreciation		13.35	9.40
- Additional depreciation		17.20	4.60
WDV as on 1.4.2020		**72.45**	**11.00**

Notes:

(1) Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014 would be eligible for depreciation @ 40%.

(2) New imported machinery was not installed during the previous year 2019-20. Hence, it would not be eligible for additional depreciation for A.Y. 2020-21. It would also not be eligible for normal depreciation for A.Y 2020-21, since it was not put to use in the P.Y.2019- 20 being the year of acquisition.

(3) It may be noted that investment in the following plant and machinery would not be eligible for additional depreciation under section 32(1)(iia):
   (a) Lorries for transporting goods to sales depots, being vehicles/road transport vehicles; and
   (b) Computers installed in office premises.

(4) As per section 2(28) of the Motor Vehicles Act, 1988, the definition of a "vehicle" excludes, inter alia, a vehicle of special type adopted for use only in a factory or in any enclosed premises. Therefore, fork-lift trucks used inside the factory would not fall within the definition of "vehicle". Hence, it is eligible for additional deprecation under section 32(1)(iia).

Question 25

(A) Examine the taxability and/ or allowability of the following receipts or expenditures under the provisions of the Income-tax Act, 1961, for the assessment year 2020-21:

(i) S Ltd. receives a sum of ₹ 10 lakhs from K Ltd. on 3rd January, 2020 for agreeing not to carry on any business relating to computer software in India for the next three years.

(ii) Secret commission was paid during the previous year 2019-20.

(iii) P Ltd. paid dollars equivalent to ₹ 50 lakhs as sales commission for the year ended 31.03.2020, without deducting tax at source, to Mr. Rodrigues, a citizen of UK and non-resident who acted as agent for booking orders, from various customers who are outside

India.

(B) Can the following transactions be covered under section 43B for disallowance?

(i) A bank guarantee given by a company towards disputed tax liabilities.

(ii) Interest payable to Goods and Services Tax Department but not paid before the due date specified in section 139(1).

Answer

(A) (i) As per section 28(va), any sum received under an agreement for not carrying out any activity in relation to any business/ profession (i.e., non-compete fee) is chargeable to income-tax under the head "Profits and gains of business or profession".

Accordingly, ₹ 10 lakhs received by S Ltd. from K Ltd. for agreeing not to carry on any business relating to computer software in India for the next three years is chargeable to income-tax under the head "Profits and gains of business or profession".

The amount shall be allowed as deduction in the hands of K Ltd. provided tax has been deducted at source under section 194J on the payment so made to S Ltd. If tax is not deducted at source, 30% of the expenditure shall be disallowed under section 40(a)(ia).

(ii) Secret commission is one of the forms of commission payment generally made by business organizations. Secret commission is a payment for obtaining business orders or contracts from parties and /or customers and paid to employees and / or officials of those parties and / or customers or companies from whom business orders are obtained by the assessee.

Explanation 1 below section 37(1) of Income-tax Act, 1961 provides that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law, shall not be deemed to have been incurred for the purpose of business and no deduction or allowance shall be made in respect of such expenditure. In view of the Explanation, any expenditure incurred for a purpose which is an offence and prohibited by law cannot be allowed as expenditure. Therefore, if secret commission payment could be established as a payment for an offence prohibited by law, the same cannot be allowed as deduction.

(iii) A foreign agent of an Indian exporter operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for booking orders by non-resident who remains outside India is not subject to tax in India, disallowance under section 40(a)(i) is not attracted in respect of payment of commission to such non-resident outside India even though tax has not been deducted at source. Thus, the amount of ₹ 50 lakhs remitted to Mr. Rodrigues outside India in foreign currency towards commission would not attract disallowance under section 40(a)(i) for non-deduction of tax at source.

(B) (i) For claiming deduction of any expense enumerated under section 43B, the requirement is, the actual payment and not deemed payment. Furnishing of bank guarantee cannot be equated with actual payment. Actual payment requires that money must flow from the assessee to the public exchequer as specified in section 43B. Therefore, deduction of an expense covered under section 43B cannot be claimed by merely furnishing a bank guarantee [CIT v. McDowell & Co Ltd (2009) 314 ITR 167 (SC)]

(ii) Interest payable to Goods and Services Tax department is part of Goods and Services Tax. Therefore, interest payable to Goods and Services Tax department, which is not paid before the "due date" of filing of return of income, would attract disallowance under section 43B [Mewar Motors v. CIT (2003) 260 ITR 218 (Raj)]

Question 26

ILT Limited is engaged in manufacturing of pipes and tubes. The profit and loss account of the company for the year ended 31st March, 2020 shows a net profit of ₹ 405 lacs. The following information and particulars are furnished to you. You are required to compute total income of the company for Assessment Year 2020-21 indicating reasons for treatment of each item.

(i) A group free air ticket was provided by a supplier for reaching a certain volume of purchase during the financial year 2019-20. The same is encashed by the company for ₹ 10 lacs in April 2019 and credited to General Reserve Account.

(ii) A regular supplier of raw materials agreed for settlement of ₹ 8 lacs instead of ₹ 10 lacs for poor quality of material supplied during the previous year which was not given effect in the running account of the supplier.

(iii) Andhra Bank sanctioned and disbursed a term loan in the financial year 2016-17 for a sum of ₹ 50 lacs. Interest of ₹ 8 lacs was in arrears. The bank has converted the arrear interest into a new loan repayable in 10 equal instalments. During the year, the company has paid 2 instalments and the amount so paid has been reduced from Funded Interest in the Balance Sheet.

(iv) The company remitted ₹ 5 lacs as interest to a company incorporated in USA on a loan taken 2 years ago. Tax deducted under section 195 from such interest has been deposited by the company on 15th July, 2020. The said interest was debited to profit and loss account.

(v) Sandeep, a sales executive stationed at HO at Delhi, was on official tour in Bangalore from 31st May, 2019 to 18th June, 2019 and 28th September, 2019 to 15th October, 2019 for the business development. The company has paid Sandeep's salary in cash, from its local office at Bangalore for the month of May, 2019 (payable on 1st June) and September 2019 (payable on 1st October), amounting to ₹ 45,000 and ₹ 47,000 respectively (net of TDS and other deduction), as Sandeep has no bank account at Bangalore. These were included in the amount of "salary" debited to Profit and Loss Account.

(vi) The company has contributed ₹ 50,000 by account payee cheque to an electoral trust and the same stands included under the head "General Expenses".

Answer

Computation of total income of ILT Ltd. for the A.Y.2020-21

Particulars	₹ (in lacs)	
Profits and gains from business or profession		
Net profit as per profit and loss account		405.00
Add : Items debited to profit and loss account, but to be disallowed and items not considered in accounts but to be taxed		
Value of group free air ticket provided by a supplier is taxable as business income under section 28(iv), as the value of any benefit, whether convertible into money or not, arising from business is taxable as business income.	10	
Amount waived by the supplier of raw materials is a deemed income under section 41(1), as the expenditure was allowed as deduction in the last year and there is a benefit by way of remission or cessation of a trading liability. The fact that effect was not given in the running account of supplier is not relevant.	2	

Interest payable outside India to a foreign company is allowable **(See Note 1 below)**	-	
Contribution to electoral trust is not an allowable expenditure while computing business income. Hence, the same has to be added back, since it is included in general expenses.	0.50	
Salary paid to employee Sandeep is eligible for deduction. Disallowance under section 40A(3) will not apply **[See Note 2 below]**	-	12.50
		417.50
Less: Amount of deduction allowable		
Under section 43B, interest on loan due to any scheduled bank, etc. is allowed as deduction, if such interest is actually paid irrespective of the method of accounting followed by the assessee. Conversion of arrear interest into a fresh loan by a bank cannot be considered as actual payment of interest. However, the amount of funded interest (i.e., converted loan) actually paid is allowable as deduction. Hence, ₹ 1,60,000, being two instalments of ₹ 80,000 each, actually paid is deductible.		1.60
Business Income		**415.90**
Gross total income		**415.90**
Less: Deduction under Chapter VI-A		
Deduction under section 80GGB in respect of contribution by the assessee company to an electoral trust.		0.50
Total Income		**415.40**

Notes:

1. Since tax has been deducted on interest payable outside India to a foreign company during the previous year 2019-20 and the same has been deposited before the due date of filing return of income under section 139(1), disallowance under section 40(a)(i) is not attracted. Since the interest has already been debited to profit and loss account, no further adjustment is required.
2. In respect of payment of salary to sales executive in cash, no disallowance under section 40A(3) is to be made as the payments fall within the scope of Rule 6DD(i). Salary paid to him in cash is allowable as the executive was temporarily posted for a continuous period of more than 15 days in Bangalore which is not the place of his normal duty. Further tax was deducted from such salary under section 192 and he does not maintain any bank account in Bangalore. No disallowance under section 40A(3) is attracted in respect of such salary.

Question 27

G Ltd., a company in which public are substantially interest, is engaged in the business of growing and manufacturing tea in India. For the previous year ended 31.03.2019, its composite business profits before allowing deduction u/s 33AB is ₹ 60,00,000. On 01.09.2019, it deposited a sum of ₹ 11,00,000 in the Tea Development Account. During the previous year 2017-18, G Ltd. had incurred a business loss of ₹ 14,00,000 which has been carried forward. On 25.01.2020, it withdrew ₹ 10 lakhs, from deposit account which is utilized as under:
₹ 6,00,000 for purchase on non-depreciable asset as per the scheme specified.

₹ 3,00,000 for purchase of machinery to be installed in the office premises.

₹ 1,00,000 was spent for the purpose of scheme on 5.4.2020.

(i) You are required to determine business income of G Ltd. and the tax consequences that may arise from the above transactions in the relevant assessment year.

(ii) What will be the consequence if the asset which was purchased for ₹ 6,00,000 is sold for ₹ 8,00,000 in April, 2020.

Answer

(i) Computation of Business Income of G Ltd. for the A.Y. 2020-21

Particulars	₹
₹ 10,00,000 being the amount withdrawn from Tea Development Account has to be utilized in the prescribed manner, otherwise, the withdrawn amount would be chargeable to tax as business income. In the given case, the taxability of withdrawal amount based on their utilization is as follows: - ₹ 6,00,000, out of the amount withdrawn from the deposit account, utilised for purchase of non-depreciable asset as per the specified scheme. [As per section 33AB(6), no deduction would be allowed under section 33AB since amount is spent out of ₹ 11 lakh deposited in Tea Development Account, which has already been allowed as deduction in A.Y.2019-20 **(See Working Note below)**].	Not taxable
- ₹ 3,00,000, being the amount utilized for purchase of machinery to be installed in the office premises is not a permissible utilization. Hence, the amount would be deemed as profits and gains of business of the previous year 2019-20 as per section 33AB(4).	3,00,000
- ₹ 1,00,000 was spent for the purpose of scheme on 05.04.2020. As per section 33AB(7), this amount would be taxable since the same is not utilized during the same previous year (i.e., P.Y. 2019-20) in which the amount is withdrawn from the deposit account.	1,00,000
When any part of withdrawal amount becomes taxable, the agricultural and non- agricultural portions of income must be segregated. Accordingly, ₹ 1,60,000, being 40% of ₹ 4,00,000 (₹ 3,00,000 + ₹ 1,00,000) would be chargeable to tax as business income and the balance ₹ 2,40,000, being 60% of ₹ 4,00,000 would be agricultural income exempt from tax.	

Working Note:

Computation of Business Income of G Ltd. for the A.Y. 2019-20

Particulars	₹
Composite business profits before allowing deduction under section 33AB	60,00,000
Less: Deduction under section 33AB(1) would be the lower of:	
- Amount deposited in Tea Development Account on or before 30.9.2019 [i.e., ₹ 11,00,000]	
- 40% of profits of such business [i.e., ₹ 24,00,000, being 40% of ₹ 60,00,000]	11,00,000
	49,00,000

Less: 60% of ₹ 49,00,000, being agricultural income **[as per Rule 8]**	29,40,000
Business income	19,60,000
Less: Brought forward business loss of A.Y.2018-19 set-off as per section 72	14,00,000
Business income chargeable to tax	5,60,000

(ii) Consequences, if asset purchased out of deposit account is sold during the previous year 2020-21

As per section 33AB(8), if the asset is sold before the expiry of eight years from the end of the previous year in which it was acquired, then, the cost of such asset shall be deemed to be the profits and gains from business or profession of the previous year in which asset is sold.

Therefore, ₹ 6,00,000 would be deemed to be the business income (composite) for the A.Y.2021-22. However, since the full cost of the asset was deducted in the assessment year 2019-20 (being part of ₹ 11 lakh deposited in Tea Development Account) before segregation of agricultural income and non-agricultural income, the agricultural and non- agricultural portions of income should be segregated in the year in which such amount becomes taxable on account of sale of asset before the expiry of eight years. Therefore, ₹ 3,60,000, being 60% of ₹ 6,00,000 would represent agricultural income. The balance ₹ 2,40,000 being 40% of ₹ 6,00,000 would be chargeable to tax as business income.

Moreover, the difference between the sale consideration and purchase price of th-e asset would be chargeable to tax as "Short term capital gains", which is computed as follows:

Sales consideration	8,00,000
Less: Cost of acquisition	6,00,000
Short term capital gain	**2,00,000**

Question 28

The trading and profit and loss account of Pingu Trading Pvt. Ltd. having business of agricultural produce, consumer items and other products for the year ended 31.03.2020 is as under:

Trading Account

Particulars	₹	Particulars	₹
Opening Stock	3,75,000	Sales	1,55,50,000
Purchases	1,25,75,000	Closing Stock	4,50,000
Freight & Cartage	1,26,000		
Gross profit	29,24,000		
	1,60,00,000		1,60,00,000

Profit and Loss Account

Particulars	₹	Particulars	₹
Bonus to staff	47,500	Gross profit	29,24,000
Rent of premises	53,500	Income-tax refund	20,000
Advertisement	5,000	Warehousing charges	15,00,000
Bad Debts	75,000		
Interest on loans	1,67,500		
Depreciation	71,500		

GST demand paid	1,08,350		
Miscellaneous expenses	5,25,650		
Net profit of the year	33,90,000		
	44,44,000		44,44,000

On scrutiny of records, the following further information and details were extracted/ gathered:

(i) There was a survey under section 133A on the business premises on 31.3.2020 in which it was revealed that the value of closing stocks of 31.3.2019 was ₹ 8,75,000 and a sale of ₹ 75,000 made on 13.3.2020 was not recorded in the books. The value of closing stocks after considering these facts and on the basis of inventory prepared by the department as on 31.3.2020 worked out at ₹ 12,50,000, which was accepted to be correct and not disputed.

(ii) Income-tax refund includes amount of ₹ 4,570 of interest allowed thereon.

(iii) Bonus to staff includes an amount of ₹ 7,500 paid in the month of December 2019, which was provided in the books on 31.03.2019.

(iv) Rent of premises includes an amount of ₹ 5,500 incurred on repairs. The assessee was under no obligation to incur such expenses as per rent agreement.

(v) Advertisement expenses include an amount of ₹ 2,500 paid for advertisement published in the souvenir issued by a political party. The payment is made by way of an account payee cheque.

(vi) Miscellaneous expenses include:

(vii) amount of ₹ 15,000 paid towards penalty for non-fulfillment of delivery conditions of a contract of sale for the reasons beyond control,

(viii) amount of ₹ 1,00,000 paid to the wife of a director, who is working as junior lawyer for taking an opinion on a disputed matter. The junior advocate of High Courts normally charge only ₹ 25,000 for the same opinion,

(ix) amount of ₹ 1,00,000 paid to an Electoral Trust by cheque.

(x) Goods and Services Tax demand paid includes an amount of ₹ 5,300 charged as penalty for delayed filing of returns and ₹ 12,750 towards interest for delay in deposit of tax.

(xi) The company had made an investment of ₹ 25 lacs on the construction of a warehouse in rural area for the purpose of storage of agricultural produce. This was made available for use from 15.09.2019 and the income from this activity is credited in the Profit and Loss account under the head "Warehousing charges".

(xii) Depreciation under the Income-tax Act, 1961 works out at ₹ 65,000.

(xiii) Interest on loans includes an amount of ₹ 80,000 on which tax was not deducted.

Compute the income chargeable to tax for assessment year 2020-21 of Pingu Trading Pvt. Ltd, ignoring MAT and provisions of section 115BAA. Support your answer with working notes.

Answer

Computation of Income of Pingu Trading Pvt. Ltd. chargeable to tax for the A.Y. 2020-21

Particulars	₹
Net profit as per profit and loss account	33,90,000

Add:	Difference in the value of stocks detected on survey under section 133A on 31.03.2020 chargeable as income **(See Note 1)**		3,75,000
			37,65,000
Less:	Income-tax refund credited in the profit and loss account, out of which interest is to be considered separately under the head "Income from other sources"		20,000
			37,45,000
Add:	**Expenses either not allowable or to be considered separately but charged in the profit & loss account**		
	Repair expenses on rented premises where assessee is under no obligation to incur such expenses are not allowable as per section 30(a)(i). However, if such expenses are required for carrying on the business efficiently, the same are allowable under section 37. In this case, assuming that such expenses are required for carrying on business efficiently, the same are allowable under section 37.		-
	Advertisement in the souvenir of political party not allowable as per section 37(2B) **(See Note 3)**		2,500
	Payment made to the wife of a director examined as per section 40A(2) and the excess payment made to be disallowed **(See Note 5)**		75,000
	Payment made to electoral trust by cheque **(See Note 6)**		1,00,000
	Penalty levied by the Goods and Services tax department for delayed filing of returns not allowable as being paid for infraction of law **(See Note 7)**		5,300
	Depreciation as per books		71,500
	30% of interest paid on loan without deduction of tax at source not allowable as per section 40(a)(ia)		24,000
			40,23,300
Less:	Depreciation allowable as per Income-tax Act, 1961		65,000
			39,58,300
Less:	Income from specified business (warehousing charges) credited to profit and loss account, to be considered separately **(See Note 8)**		15,00,000
Income from business (other than specified business)			**24,58,300**
Computation of income/ loss from specified business (See Note 8)			
Income from specified business		₹ 15,00,000	
Less: Deduction under section 35AD @ 100% of ₹25 lakhs		₹ 25,00,000	
Loss from specified business to be carried forward as per section 73A		**₹ (10,00,000)**	
Income from Other Sources			
Interest on income-tax refund			4,570
Gross Total Income			**24,62,870**
Less:	**Deduction under section 80GGB**		

Contribution to political party **(See Note 3)**	₹ 2,500	
Contribution to an Electoral trust **(See Note 3)**	₹ 1,00,000	1,02,500
Total Income		**23,60,370**

Notes:

(1) The business premises were surveyed and differences in the figures of opening and closing stocks and sales were found which have not been disputed and accepted by the assessee. Therefore, the trading account for the year is to be re-cast to arrive at the correct amount of the gross profit/ net profit for the purpose of return of income to be filed for the previous year ended on 31.3.2020.

Revised Trading Account

Particular	₹	Particular	₹
Opening Stock	8,75,000	Sales (₹ 1,55,50,000 +₹ 75,000)	**1,56,25,000**
Purchases	1,25,75,000	Closing Stock	**12,50,000**
Freight and Cartage	1,26,000		
Gross Profit	32,99,000		
	1,68,75,000		1,68,75,000

The difference of gross profit of ₹ 32,99,000 - ₹ 29,24,000 = ₹ 3,75,000 is to be added as income of the business for the year.

(2) Bonus for the previous year 2018-19 paid after the due date for filing return for that year would have been disallowed under section 43B for the P.Y.2018-19. However, when the same has been paid in December 2019, it should be allowed as deduction in the P.Y.2019- 20 (A.Y.2020-21). Since it is already included in the figure of bonus to staff debited to profit and loss account of this year, no further adjustment is required.

(3) The amount of ₹ 2,500 paid for advertisement in the souvenir issued by a political party attracts disallowance under section 37(2B). However, such expenditure falls within the meaning assigned to "contribute" under section 293A of the Companies Act, 1956, and is hence, eligible for deduction under section 80GGB. Any contribution to the political party or electoral trust made by way of cash is not allowed as deduction under section 80GGB. Since in the present case, the payment to the political party is made by way of an account payee cheque, it is allowed as deduction under section 80GGB.

(4) The penalty of ₹ 15,000 paid for non-fulfilment of delivery conditions of a contract for reasons beyond control is not for the breach of law but was paid for breach of contractual obligations and therefore, is an allowable expense.

(5) It has been assumed that ₹ 25,000 is the reasonable payment for the wife of Director, working as a junior lawyer, since junior advocates of High Courts normally charge only

(6) ₹ 25,000 for the same opinion and therefore, the balance ₹ 75,000 has been disallowed.

(7) Payment to an electoral trust qualifies for deduction under section 80GGB since the payment is made by way of a cheque. However, since the amount has been debited to profit and loss account, the same has to be added back for computing business income.

(8) The interest of ₹ 12,750 paid on the delayed deposit of goods and services tax is for breach of contract and hence, is allowable as deduction. However, penalty of ₹ 5,300 for delay in filing of returns is not allowable since it is for breach of law.

(9) Deduction @ 100% of the capital expenditure is available under section 35AD in respect of specified business of setting up and operating a warehouse facility for storage of agricultural produce which commences operation on or after 1.04.2012. It is presumed that ₹ 25 lacs does not include expenditure on acquisition of any land.

(10) The loss from specified business under section 35AD (warehousing) should be segregated from the income from other businesses, since, as per section 73A(1), any loss computed in respect of

any specified business referred to in section 35AD shall not be set off except against profits and gains, if any, of any other specified business.

In view of the provisions of section 73A(1), the loss of ₹ 10 lacs from the specified business cannot be set-off against income from other businesses. Such loss has to be carried forward to be set-off against profit from specified business in the next assessment year. The return should be filed on or before the due date under section 139(1) for carry forward of such losses.

Question 29

(a) A Ltd. paid IDBI (a public financial institution) a lump sum pre-payment premium of ₹ 1.2 lacs on 7.4.2019 for restructuring its debts and reducing its rate of interest. It claimed the entire sum as business expenditure for the P.Y.2019-20. The Assessing Officer, however, held that the pre-payment premium should be amortised over a period of 10 years (being the tenure of the restructured loan), and thus, allowed only 10% of the pre-payment premium in the P.Y.2019-20. Discuss, with reasons, whether the contention of A Ltd. is correct or that of the Assessing Officer.

(b) Explain the tax treatment of emergency spares (of plant and machinery) acquired during the year which, even though kept ready for use, have not actually been used during the relevant previous year.

Answer

(a) This issue came up before the Delhi High Court in CIT v. Gujarat Guardian Ltd (2009) 177 Taxman 434.The Court observed that the assessee company's claim for deduction has to be allowed in one lump sum keeping in view the provisions of section 43B(d), which provide that any sum payable by the assessee as interest on any loan or borrowing from any financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the periods, in which the liability to pay such sum is incurred by the assessee according to the method of accounting regularly followed by the assessee. The High Court concurred with the Tribunal's view supporting the assessee that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable. Since there was no dispute that the pre-payment premium was nothing but interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, in terms of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the payment has actually been made.

Therefore, applying the ratio of the above case, the contention of A Ltd. is correct and not that of the Assessing Officer.

Note – Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A) defines interest to include, inter alia, any other charge in respect of the moneys borrowed or debt incu rred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –

(i) pre-payment premium represents interest as per section 2(28A);
(ii) such interest is deductible as business expenditure as per section 36(1)(iii);
(iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).

(b) As per ICDS V on Tangible Fixed Assets, machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised. Where the spares are capitalised as per the above requirement, the issue as to provision of depreciation arises – whether depreciation can be provided where such spares are kept ready for use or is it necessary that they are actually put to use. This issue was dealt with by the

Delhi High Court in CIT v. Insilco Ltd (2010) 320ITR 322. The Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note – One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is "kept ready for use". For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term "use" embraces both active use and passive use for business purposes.

Question 30

"Easy Call Ltd.", to provide telecom services in Mumbai, obtained a licence on 1.4.2017 for a period of 10 years ending on 31.3.2027 against a fee of ₹ 27 lacs to be paid in 3 installments of ₹ 9 lacs each by April, 2017, April, 2018 and April, 2019, respectively. The company has commenced business on 1.5.2018.

Explain, how the payment made for licence fee shall be dealt with under the Income-tax Act, 1961 and the amount, if any, deductible for A.Y. 2020-21.

Answer

The payment made for acquiring the licence to operate telecom services in Mumbai shall be subject to deduction as per the scheme in section 35ABB. As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services shall be allowed as deduction in equal instalments during the number of years for which the license is in force.

If the payment is made before the commencement of business: The deduction shall be allowed beginning with the year of commencement of business.

In any other case: It will be allowed commencing from the year of payment. Deduction shall be allowed up to the year in which the license shall cease to be in force.

The amount of deduction available for A.Y. 2020-21 is worked out below:-

(1)	(2)	(3)	(4) = (3)/(2)
Previous year of payment	**Unexpired period of license**	**Instalment paid (₹)**	**Deduction in respect of each instalment (₹)**
2017-18	9 years	9,00,000	1,00,000
2018-19	9 years	9,00,000	1,00,000
2019-20	8 years	9,00,000	1,12,500
		27,00,000	**3,12,500**

The deduction under section 35ABB from assessment year 2020-21 shall be ₹ 3,12,500.

Question 31

Alpha Ltd., a manufacturing company, has disclosed a net profit of ₹ 12.50 lacs for the year ended 31st March, 2020. You are required to compute the taxable income (ignore the provisions of section 115BAA) of the company for the Assessment year 2020-21, after considering the following information, duly explaining the reasons for each item of adjustment:

(i) Advertisement expenditure debited to profit and loss account includes the sum of ₹ 60,000 paid in cash to the sister concern of a director, the market value of which is ₹ 52,000.

(ii) Repairs of plant and machinery debited to profit and loss account includes ₹ 1.80 lacs towards replacement of worn out parts of machineries. Such expenditure does not increase the future benefit from the asset beyond its previously assessed standard of performance.

(iii) A sum of ₹ 6,000 on account of liability foregone by a creditor has been taken to general reserve. The original purchases was debited to the Profit & Loss Account in the A.Y.2015-16.

(iv) Sale proceeds of import entitlements amounting to ₹ 1 lac has been credited to Profit & Loss Account, which the company claims as capital receipt not chargeable to income-tax.

(v) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority:
   (a) Research equipments purchased ₹ 1,50,000.
   (b) Remuneration paid to scientists ₹ 50,000.

The total amount of ₹ 2,00,000 is debited to the profit and loss account.

Answer

Computation of taxable income of Alpha Ltd. for the A.Y.2020-21

Particulars	₹
Net profit as per profit and loss account	12,50,000
Add: Items debited to profit and loss A/c but not deductible or income to be taxed	
1. **Payment of advertisement expenditure of ₹60,000**	
(i) ₹ 8,000, being the excess payment to a relative disallowed under section 40A(2)	8,000
(ii) As the payment is made in cash and since the remaining amount of ₹ 52,000 exceeds ₹ 10,000, 100% shall be disallowed under section 40A(3)	52,000
2. Under section 31, expenditure relatable to current repairs regarding plant, machinery or furniture is allowed as deduction.	
The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or substantial part of the entire machinery [CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)].	
Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs. Hence, no adjustment is required.	
Further, as per ICDS V on Tangible Fixed Assets, only an expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance has to be added to the actual cost.	

3.	Liability foregone by creditor chargeable as business income but not credited to profit and loss account [taxable under section 41(1)]	6,000
4.	Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iiia). As the amount has already been credited to profit and loss account, no further adjustment is necessary.	-
Less: Amount not debited to profit and loss account but allowable as deduction		
5.	Expenditure on in-house research and development is entitled to a weighted deduction of 150% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1) = ₹2 lacs x 150% = ₹3 lacs	
	Expenditure of ₹ 2,00,000 has already been debited to Profit & Loss Account, therefore only additional deduction of ₹ 1 lacs further to be allowed	1,00,000
Taxable Income		**12,16,000**

Question 32

(i) A corporation was set up by the State Government transferring all the buses owned by it for a consideration of ₹ 75 lacs, which was discharged by the Corporation by issue of equity shares. The Corporation in its assessment claimed depreciation. Can the depreciation be denied in the Corporation's hands on the ground that there was no registration of the buses in favour of the Corporation?

(ii) Ravi succeeded to his father's business in the year 2017. In the previous year ended 31.3.2020, Ravi has written off the balance in the name of 'Y' which relates to supply made by his father, when he carried on business. Ravi desires to know whether the write off could be eligible for deduction.

Answer

(i) The decision of the Supreme Court in Mysore Minerals Ltd v. CIT (1999) 239 ITR 775 is relevant in the context of the facts stated. The term "asset used" in section 32 must be assigned a wider meaning and anyone in possession of property in his own title, exercising dominion over the property, to the exclusion of others and having the right to use and enjoy it, must be taken to be the owner.

Registration of the buses is only a formality to perfect the title and does not bar enjoyment. The Corporation cannot, therefore, be denied depreciation on the buses. A similar decision was also taken in CIT v. J & K Tourism Development Corporation (2001) 248 ITR 94 (J&K).

(ii) The deduction of bad debt is allowed if it is written off in the books of account of the assessee. In this case, Ravi has succeeded to the business carried on by his father. Under clause (vii) of section 36(1) the amount has been written off in the books of account as irrecoverable is eligible for deduction provided the debt has been taken into account in computing the income of the business in an earlier previous year [vide section 36(2)].

Therefore, Ravi is eligible for deduction in respect of the amount due in the name of Y which is written off in the books of account as bad debt, even though the debt represents the amount due for the supplies made by previous owner viz. deceased father of Ravi.[CIT v. T. Veerabhadra Rao, K. Koteswara Rao and Co (1985) 155 ITR 152 (SC)].

Question 33

Boat Club is an association governed by the provisions of Section 44A of the Income-tax Act, 1961.The subscription received from members for the year ended 31st March, 2020 was ₹ 2,00,000. The expenditures in the normal course of its activities were ₹ 3,85,000. Its other income taxable under the Act works out to ₹ 2,75,000. You are consulted as to how Boat Club's income would be determined for assessment year 2020-21?405

Answer

As per section 44A, the deficiency arising on account of income from members by way of, inter alia, subscriptions, falling short of the expenditure incurred solely for the protection or advancement of the interest of its members, shall first be set off against the association's income under the head "Profits and gains of Business or Profession". If there is no such income under this head, the deficiency shall be set off against income under any other head.

Particulars	₹
Income from subscription	2,00,000
Less: Expenses incurred in the course of its activities	3,85,000
Deficiency	(-)1,85,000
Other income	2,75,000
Less: Deficiency ₹1,85,000 but limited to 50% of other income	1,37,500
Income of the Association	**1,37,500**

There is a ceiling on the deduction admissible by way of deficiency being that it shall not exceed one-half of the total income of the association computed before making any allowance under this section. This ceiling has been exceeded above and the deficiency hence is limited to ₹ 1,37,500 being one-half of ₹2,75,000 [Section 44A(3)].

Section B – Additional Questions

Question 34

"Rameshwarm" after purchase put to use on 15-12-2017 a machine worth ₹ 3,00,000 which is eligible for depreciation @ 15% under the Act. He sold this machine to "Ganesham" on 1-1-2019 for ₹ 3,20,000 (FMV on that date was ₹ 2,50,000), who after having used the machine for his business purposes again sold it back to "Rameshwarm" on 15-11-2019 for ₹ 3,10,000.
Compute the amount of allowable depreciation and of chargeable capital gain, if any, for assessment years 2018-19 to 2020-21 assuming that this was the only machine in the block of asset held by both "Rameshwarm" and "Ganesham".

Answer

Computation of allowable depreciation/ chargeable capital gains
In case of Rameshwarm

	₹
Assessment year 2018-19 (P.Y. 2017-18)	
WDV as on 01-04- 2017	
Addition during the year on 15-12- 2017	3,00,000
	3,00,000
Less: Depreciation @ 7.5% (since the machinery is put to use for less than 180 days)	22,500
WDV as on 01-04-2018	**2,77,500**

Assessment year 2019-20 (P.Y.2018-19)	
Actual Sale consideration – 01.01.2019	3,20,000
Less: WDV as on 01-04-2018	2,77,500
Short-term capital gains chargeable to tax under section 50	42,500
Assessment year 2020-21 (P.Y.2019-20)	
WDV as on 01-04-2019	Nil
Addition during the year on 15-11-2019 [See Note 1]	2,77,500
	2,77,500
Less: Depreciation @ 7.5% (since machinery is put to use for less than 180 days)	20,813
WDV as on 01-04-2020	**2,56,687**

In case of Ganesham

	₹
Assessment year 2019-20 (P.Y.2018-19)	
WDV as on 01-04-2018	Nil
Addition during the year on 01-01-2019 [See Note 2]	2,50,000
	2,50,000
Less: Depreciation @ 7.5% (since the machinery is put to use for less than 180 days)	18,750
WDV as on 01-04-2019	2,31,250
Assessment year 2020-21(P.Y.2019-20)	
Actual Sale consideration – 15.11.2019	3,10,000
Less: WDV as on 01-04-2019	2,31,250
Short-term capital gains chargeable under section 50	**78,750**

Notes:

1. As per Explanation 4 to section 43(1), where an asset which had once belonged to the assessee and had been used by him for the purpose of his business and thereafter, ceased to be his property by reason of transfer or otherwise, is re-acquired by him, the actual cost to the assessee shall be lower of the following:
   (a) Actual cost when he first acquired the asset minus the depreciation actually allowable to him till the date of transfer (i.e., ₹ 2,77,500, in this case); or
   (b) Actual price for which it is re-acquired (i.e., ₹ 3,10,000).

   Therefore, in this case, the actual cost of machinery reacquired by Rameshwarm would be ₹ 2,77,500, being the lower of the two amounts given above.

2. As per Explanation 3 to section 43(1), where the assets were at any time, before the date of acquisition by the assessee, used by any other person for the purposes of business or profession and the Assessing Officer is satisfied that the main purpose of the transfer of such asset was the reduction of his liability (by claiming excess depreciation with reference to enhanced cost), the actual cost to the assessee shall be such an amount as determined by the Assessing Officer, with the previous approval of the Joint Commissioner.

   Consequently, the cost of machinery in the hands of Ganesham would be ₹ 2,50,000, assuming that the fair market value given in the question is the amount determined by the Assessing Officer, with the previous approval of the Joint Commissioner.

Question 35

The business profit of T Ltd., a tea growing and manufacturing company, is ₹ 120 lacs (before deduction under section 33AB) for the assessment year 2020-21. It deposits ₹ 50 lacs with NABARD for claiming deduction under section 33AB. It wants to claim set-off of brought forward business loss of ₹ 40 lacs of the assessment year 2013-14. Find out the taxable income of T Ltd. for the assessment year 2020-21.

Answer

An assessee, engaged in growing and manufacturing tea in India, is entitled to a deduction u/s 33AB, in respect of amount deposited to an account maintained with NABARD as per scheme approved by Tea Board. The deduction is lower of the following two amounts –

(i) Amount deposited to the account maintained with NABARD within 6 months from end of the previous year or before the "due date" for filing return of income, whichever is earlier;
(ii) 40% of profits of such business computed under the head "Profits and Gains of Business or Profession" before making any deduction under this section.

The above deduction will be allowed before set off of brought forward business loss u/s 72.

Computation of taxable income of T Ltd. for the A.Y.2020-21

Particulars	₹ (in lacs)	₹ (in lacs)
Profit before deduction under section 33AB		120.00
Less: Deduction under section 33AB for deposit to the account with NABARD being lower of the following amounts:		
Amount deposited with NABARD	50	
40% of business profit i.e., 40% of ₹ 120 lacs	48	48.00
		72.00
Less: 60% of ₹ 72 lacs, being agricultural income as per Rule 8		43.20
		28.80
Less: Set of brought forward loss under section 72 of A.Y.2013-14		28.80
Taxable business income		**Nil**
Total Income		**Nil**

Note - The balance business loss of ₹ 11.20 lacs (i.e., ₹ 40 lacs – ₹ 28.80 lacs) can be carried forward to the next year for set off against business income.

Question 36

XYZ Limited acquired a machine on 1st April, 2019 for ₹ 10 crores by availing 70% loan facility from a bank. The machine was put to regular use from 1st February, 2020. Interest on loan is charged at 12% per annum.
Advise XYZ Limited on the treatment of interest payment made on this loan and depreciation allowable for A.Y. 2020-21. Assume that this machine is the only machine in the said block of assets.

Answer

(i) Interest on term loan for purchase of machinery: As per section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for a period beginning from the date of borrowal of loan for acquiring the asset till the date on which such asset is first put to use is not allowable as deduction but has to be captialised by adding the same to the cost of the asset. Therefore, interest@12% p.a. for a period of 10 months from 1st April, 2019 to 31st January, 2020 on ₹ 7 crores, being the amount of loan, is to be capitalized

Cost of machinery	10,00,00,000
Add: Interest [12% × 10/12 × ₹ 7,00,00,000]	70,00,000
Actual Cost of machinery	**10,70,00,000**
Interest @12% for two months (February, 2020 & March, 2020) after the asset is put to use is allowable as deduction under section 36(1)(iii) [12% × 2/12 × ₹ 7,00,00,000]	**14,00,000**

(ii) **Depreciation**

	₹
Since the machinery is put to use for less than 180 days in the previous year 2019-20, the depreciation would be restricted to 50% of the amount calculated at the prescribed percentage of 15%.	
Therefore, depreciation = 50% ×[15% × ₹10,70,00,000]	80,25,000
Likewise, the additional depreciation would also be restricted to 50% of the amount calculated at the prescribed percentage of 20%, assuming that XYZ Ltd. is engaged in the manufacture or article or thing and that the machinery acquired is a new machinery.	
Therefore, additional depreciation= 50% × [20% × ₹ 10,70,00,000]	1,07,00,000
	1,87,25,000

Question 37

Atul Housing Finance Co. Ltd., engaged in the business of providing long-term finance for construction or purchase of houses in India for residential purposes, provides you the following particulars from its accounts for the year ended on 31.3. 2020 and seeks your opinion as to availability of deduction under section 36(1)(viii) and the amount there of:

Profits from the business computed as per Part D of Chapter IV of the Income-tax Act, 1961, but before claiming deduction under section 36(1)(viii) is ₹ 560 lacs

Paid-up share Capital	₹ 500 lacs
General Reserve	₹ 100 lacs
Balance in reserve created under section 36(1)(viii) on 31.3.2019	₹ 1,100 lacs

Answer

According to section 36(1)(viii), a special deduction is allowed to specified entities engaged in eligible business. A housing finance company is a specified entity which is eligible for deduction under section 36(1)(viii) in respect of profits derived from the eligible business of providing long-term finance for construction or purchase of houses in India for residential purposes. The quantum of deduction, however, should not exceed 20% of the profits derived from eligible business computed under the head "Profits and gains of business or profession" (before making deduction under section 36(1)(viii)) carried to a special reserve account.

However, where the aggregate amount carried to such reserve account exceeds twice the amount of paid up share capital and general reserve, no deduction shall be allowed in respect of such excess.

Atul Housing Finance Co. Ltd. is a specified entity engaged in carrying on the eligible business of providing long-term finance for the construction or purchase of houses in India for residential purposes and accordingly, it is entitled to claim the deduction under section 36(1)(viii).

The maximum deduction would be ₹ 112 lacs (20% of ₹ 560 lacs, being the profits for the year). However, in such a case, the aggregate amount carried to special reserve account i.e. ₹ 1,212 lacs (₹ 1,100 lacs + ₹ 112 lacs) would exceed twice the amount of paid-up share capital and general reserve i.e., ₹ 1,200 lacs (2 x ₹ 600 lacs). Therefore, deduction will not be allowed under section 36(1)(viii) in respect of the excess ₹ 12 lacs (₹ 1,212 lacs – ₹ 1,200 lacs). Deduction under section 36(1)(viii) for the A.Y.2020-21 would be ₹ 100 lacs (₹ 1,200 lacs – ₹ 1,100 lacs).

Question 38

A partnership firm consisting of three partners X, Y and Z is engaged in the business of manufacturing and selling toys.

Turnover of the business for the year ended 31st March, 2020 amounts to ₹ 95 lakh (received in cash). Bad debts written off in the books are ₹ 75,000. Interest at 12% is provided to partner Z on his capital of ₹ 6 lakh as authorized by the partnership deed.

The firm had business loss of ₹ 50,000 and unabsorbed depreciation of ₹ 1,50,000 carried forward from Assessment Year 2019-20. The firm did not pay tax under presumptive tax system in assessment year 2019-20. The firm opts for presumptive taxation under section 44AD for Assessment Year 2020-21.

Compute the income of the firm chargeable under the head "Profits and gains of business or profession."

Answer

Computation of income of the firm chargeable under the head "Profits and Gains of business or profession"

Particulars	₹
Presumptive income under section 44AD (8% of ₹ 95 lakh) **[See Note 1]**	7,60,000
Less: Brought forward business loss under section 72 **[See Note 3]**	50,000
Income of the firm chargeable under the head **"Profits and Gains of business or profession"**	**7,10,000**

Notes: -

(1) A partnership firm falls within the definition of "eligible assessee" under section 44AD. The threshold limit of turnover for applicability of presumptive taxation scheme under section 44AD is ₹ 100 lakh. In this case, since the turnover of the business of the firm is ₹ 95 lakh, it falls within the definition of "eligible business" and therefore, the firm is eligible to opt for presumptive taxation under section 44AD. 8% of the total turnover would be deemed to be

the business income of the firm.

(2) As per section 44AD(2), all deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed Accordingly, no deduction shall be allowed for bad debts since the same is deductible under section 36(1)(vii) and similarly unabsorbed depreciation is not deductible since the same is deductible under section 32(2).

(3) Further, business loss of previous year 2014-15 can be set-off against current year business income as per section 72.

Question 39

X Co. Ltd. was amalgamated with Y Co. Ltd. on 30.04.2019. X Co. Ltd. was engaged in real estate whereas Y Co. Ltd. was engaged in manufacture of textile articles. Y Co. Ltd. on amalgamation altered its objects clause of Memorandum of Association, to carry on real estate business.
The stock in trade of X Co. Ltd. (being vacant lands) was taken over at ₹ 140 lacs by Y Co. Ltd. as against their original cost of ₹ 125 lacs to X Co. Ltd. for the purpose of amalgamation. Y Co. Ltd incurred ₹ 25 lacs towards development of those lands obtained on amalgamation. It sold the entire land for ₹ 160 lacs during the year ended 31.03.2020.
Determine the tax implication of the transaction in the hands of Y Co. Ltd. for the A.Y.2020-21.

Answer

The provisions of section 43C would be attracted in this case. Where an asset, not being an asset referred to in section 45(2), which becomes the property of an amalgamated company under a scheme of amalgamation is sold by the amalgamated company as its stock in trade, then, the cost of acquisition of the said asset to the amalgamated company in computing the profits and gains derived from sale of such asset would be the cost of acquisition of such asset to the amalgamating company plus the cost of any improvement incurred thereto and the expenditure incurred wholly and exclusively in connection with such transfer by the amalgamating company.

In this case, since the stock-in-trade of X Co. Ltd. is taken over by Y Co. Ltd. on amalgamation, the provisions of section 43C are attracted and the cost of acquisition of vacant lands to Y Co. Ltd. (the amalgamated company) will be ₹ 125 lacs, being the original cost of such lands to X Co. Ltd., the amalgamating company. Since the stock in trade of X Co. Ltd. (being vacant land) is taken over by Y Co. Ltd., which has altered its object clause on amalgamation to include real estate business, a view can be taken that the provisions of section 45(2) are not attracted in this case.
The business income of Y Co. Ltd. on sale of such lands would be calculated as under -

Particulars	₹ (in lacs)	
Sale price (in the hands of Y Co. Ltd.)		160
Less: Cost of acquisition under section 43C, being the original cost to the amalgamating company, X Co. Ltd.	125	
Cost of improvement (incurred by Y Co. Ltd)	25	150
Taxable business income chargeable in the hands of Y Co. Ltd		**10**

Question 40

'X' Ltd., transferred its fertilizer business to a new company ' Y ' Ltd., by way of demerger with effect from appointed date of 1.4.2019 after satisfying the conditions of demerger. Further information given:

(a) WDV of the entire block of plant and machinery held by 'X' Ltd. as on 1.4.2019 is ₹ 100

crores;
(b) Out of the above, WDV of block of plant and machinery of fertilizer division is 70 crores;
(c) 'X' Ltd. has unabsorbed depreciation of ₹ 50 lacs as at 31.3.2019;

On the above facts:
(i) You are required to explain the provisions of the Income-tax Act as regards allowability of depreciation, after demerger, in the hands of 'X' Ltd. and 'Y' Ltd. as at 31.3. 2020 duly calculating the depreciation.
(ii) State how the unabsorbed depreciation has to be dealt with for the assessment year 2020-21

Answer

(i) In the case of a demerger, satisfying the conditions as laid down in section 2(19AA), the depreciation claim is governed by the provisions as under –

(1) As per the Explanation 7A below section 43(1), where in a scheme of demerger, if the demerged company transfers any capital asset to the resulting company, being an Indian company, the actual cost of the capital asset transferred shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business.

(2) The resulting company will be entitled to depreciation on the written down value of the block of assets transferred to it, which will be the written down value of the transferred assets of the demerged company immediately before the demerger [Explanation 2B to section 43(6)].

(3) Explanation 2A to section 43(6) provides that the written down value of the block of assets in the hands of the demerged company shall be the written down value of the block of assets of the demerged company for the immediately preceding previous year as reduced by the written down value of the assets transferred to the resulting company pursuant to the demerger.

(4) As per the above provisions, the calculation of depreciation on plant and machinery in the hands of 'X' Ltd. and 'Y' Ltd. is as under:

Particulars	₹ (in crores)	
	"X" Ltd.	"Y" Ltd.
WDV of plant and machinery as at 1st April, 2019	30.00	70.00
Add: Acquisition during the year	Nil	Nil
Less: Sale during the year	Nil	Nil
WDV as at 31st March, 2020 (before charging depreciation)	30.00	70.00
Less: Depreciation @ 15%	4.50	10.50
WDV as at 1st April, 2020	**25.50**	**59.50**

Note – It is presumed that Y Ltd. is an Indian company.

(ii) Set-off of unabsorbed depreciation:

(i) As per section 72A(4), on demerger, the unabsorbed depreciation directly relatable to the undertakings transferred to the resulting company is allowed to be carried forward and set off in the hands of the resulting company.

(ii) Where such unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting company, it has to be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company.

(iii) The demerged company and the resulting company would be allowed to carry forward and set-off their respective portion of unabsorbed depreciation, as

calculated above, for an unlimited period as per section 32(2).

Question 41

Ram, Rahim & Robert are equal partners of SSK & Co., which was formed w.e.f 01.06.2019. The firm is an authorized dealer of watches manufactured by a reputed company. It reported Net Profit as per profit and loss account of ₹ 2,50,000 after debit / credit of the following items:

(i) Depreciation on generator and computers ₹ 1,10,000.

(ii) Working partners' salary ₹ 30,000 per month for each partner.
All the partners are working partners and the salary paid is authorized by the deed of partnership.

(iii) Interest on capital to partners @ 18% per annum. The total interest on capital of the firm debited to profit and loss account being ₹ 3,60,000.

(iv) Donation to registered political parties ₹ 80,000 by cash and ₹ 70,000 by electronic transfer.

(v) Monthly rent paid to partner Ram for use of his premises as godown ₹ 30,000 and it is occupied from 01.10.2019. The market rent for the premises is ascertained at ₹ 15,000 per month. No tax was deducted at source on the rent paid.

(vi) Sponsorship fee for local Cricket tournament ₹ 4,00,000.

(vii) The firm incurred ₹ 5 lakhs by way of expenditure towards the cost of gold coins awarded to customers on the first day of their showroom inauguration. The cost of each gold coin was less than ₹ 10,000 and one coin was given for each of the buyers on that day selected through lucky dip. No tax was deducted at source on such gold coins given to the customers.

Additional information:

(i) Depreciation on tangible assets allowable u/s 32 ₹ 2,37,500.

(ii) One registered trademark was acquired on 10.07.2019 for ₹ 3,00,000. The firm used the trademark w.e.f. 01.12.2019 since there was some dispute in title of the previous owner and was cleared through court decree only in November 2019.

(iii) The total turnover for the firm for the year ended 31.03.2020 was ₹ 80 lakhs. Amount realized by cash ₹ 20 lakhs and the balance of sale proceeds were received through credit card/RTGS/NEFT before 31.03.2020.

You are required to compute the total income of the firm applying regular provisions and presumptive provisions contained in section 44AD of the Income-tax Act, 1961(Act). Advise the procedural requirement on opting any of the provisions for the purpose of the Act.

Answer

Computation of total income of the firm, SSK & Co. for the A.Y. 2020-21 applying the regular provisions of the Income-tax Act,1961

Particulars	₹	₹
Net profit as per profit & loss account		2,50,000
Add: **Expenditure debited to profit & loss account but not allowable as deduction or to be considered separately**		
- Depreciation as per books of accounts	1,10,000	
- Salary paid to working partners considered separately [₹ 30,000 x 3 partners x 10 months]	9,00,000	
- Interest on capital paid to partners in excess of 12% disallowed. Accordingly, ₹ 1,20,000 [₹ 3,60,000 – ₹ 2,40,000 (₹3,60,000 x 12/18)], is disallowed	1,20,000	

- Donation to registered political party [Donation paid to a political party is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income]	1,50,000	
- Excess rent paid to a partner would be disallowed under section 40A(2), since partner is a related person of the firm [(₹ 30,000 - ₹15,000) x 6] [No disallowance would be attracted for non-deduction of tax at source, since the amount of rent does not exceed ₹1,80,000**]**	90,000	
- Sponsorship fee for local cricket tournament [Such expenditure is incurred for the promotion of the business of the firm/incurred out of business expediency and is an allowable expenditure u/s 37]	Nil	
- Expenditure on gold coins awarded to customers [Allowed as expenditure u/s 37. No disallowance would be attracted for non-deduction of tax at source, since the value of gold coin awarded to each customer does not exceed ₹ 10,000]	Nil	13,70,000
		16,20,000
Less: Depreciation as per Income-tax Act, 1961		
- Tangible assets	2,37,500	
- Intangible asset–registered trademark [₹ 3,00,000 x 12.5%] [50% of 25%, being the depreciation allowable as deduction, since the asset is put to use for less than 180 days during the year of acquisition]	37,500	
		2,75,000
Book Profit		13,45,000
Less: Salary to working partners:		
(i) As per prescribed limits		
On first ₹ 3,00,000 @ 90%	2,70,000	
On the balance of ₹ 10,45,000 @ 60%	6,27,000	
	8,97,000	
(ii) Salary actually paid	9,00,000	
Deduction allowed being (i) or (ii) whichever is less		8,97,000
Profits and gains from business or profession		**4,48,000**
Gross Total Income		**4,48,000**
Less: Deduction under Chapter VI-A		
Under section 80GGC Donation to registered political party		
• Paid by cash not allowable	Nil	
• ₹ 70,000 paid by electronic transfer would be allowed as deduction, since payment is made in a mode other than cash;	70,000	70,000
Total Income		**3,78,000**

Computation of Total Income of A.Y.2020-21 in accordance with presumptive provisions contained under section 44AD

For the P.Y.2019-20, the turnover of the firm business is ₹ 80 lakhs. Since its turnover is less than ₹ 200 lakhs, the firm is eligible to opt for presumptive tax scheme under section 44AD.

Accordingly, the business income would be computed applying the presumptive rates of taxation under section 44AD

Particulars	₹
(i) Cash sales = 8% x ₹ 20 lakhs	1,60,000
(ii) Online sales = 6% x ₹ 60 lakhs	3,60,000
[No deduction in respect of any expenditure including working partners' salary is allowable while computing presumptive business income as per the provisions of section 44AD].	
Business Income/Gross Total Income [₹ 1,60,000 + ₹ 3,60,000]	**5,20,000**
Less: Deduction under Chapter VI-A	
Under section 80GGC [Donation to registered political party]	70,000
Total Income	**4,50,000**

In case the firm wants to declare income of ₹ 3,78,000 as per books of account, advance tax has to be paid in four installments, in the absence of which interest liability under section 234C would be attracted in respect of shortfall in each of the four installments.

However, if the firm declares profits of ₹ 4,50,000 on presumptive basis under section 44AD, advance tax has to be paid in one installment in March, 2020, in the absence of which interest under section 234C would be attracted only for one month.

Question 42

BG (P) Ltd. is engaged in multiple businesses. The Net Profit as per the statement of profit and loss was ₹ 52 lakhs for the year ended 31.03.2020. A scrutiny of the statement of profit and loss revealed the following items which were debited / credited therein:

(i) Share income @ 25% from a partnership firm ABC & Co. of Pune ₹ 9,50,000.

(ii) The company paid ₹ 1 lakh as service charges to a call centre for attending the calls of customers and suppliers. Tax was deducted at source on such payment @ 2%.

(iii) Expenditure incurred ₹ 8 lakhs for digging of wells near the factory for use by public under Corporate Social Responsibility Scheme as per the Companies Act, 2013.

(iv) Grant received from State Government for acquisition of generator ₹ 10 lakhs. The generator was acquired on 01.06.2019 for ₹ 35 lakhs. A sum of ₹ 5 lakhs was paid as advance by cash to the supplier of generator. The grant amount received is credited to statement of profit and loss. Depreciation charged on ₹ 35 lakhs@15%.

Note : Assume that the company is not eligible for additional depreciation.

(v) During the year, the company bought textile goods from local suppliers. Cash payment was made exceeding ₹ 10,000 but below ₹ 20,000 in a day to 15 suppliers aggregating to ₹ 2,00,000.

(vi) Depreciation debited to statement of profit and loss ₹ 10 lakhs (it includes ₹ 8 lakhs being depreciation on assets revalued).

(vii) Provision for deferred tax debited to statement of profit and loss ₹ 6,50,000.

(viii) Trade creditors ₹ 5,00,000 were outstanding for more than 5 years and there is no business relationship with them. The amount was unilaterally transferred to credit of statement of profit and loss.

(ix) Royalty income in respect of patents chargeable under section 115BBF ₹ 12,00,000.

(x) Depreciation eligible under section 32 (before considering adjustment of any of the items described above) ₹ 12,25,000. (not debited to P&L)

Additional information:

(a) The assessee executed only one civil construction contract of the value of ₹ 15 lakhs. The contractee withheld 20% of the contract amount which would be released only after 2

years. The amount withheld has not been credited to statement of profit and loss.

(b) During the year, 1,00,000 equity shares of ₹ 10 each was issued for ₹ 25 per share. The fair market value of the shares as per rule 11UA of the Income-tax Rules, 1962 was determined @ ₹ 17 per share.

You are required to compute the total income for the assessment year 2020 -21 stating clearly the reasons for treatment for each of the items given above.

Answer

Computation of Total Income of BG (P) Ltd. for the A.Y.2020-21

Particulars	Amount (₹)	
Profits and gains of business and profession		
Net profit as per the statement of profit and loss		52,00,000
Add: Items debited but to be considered separately or to be disallowed		
(ii) Service charges paid to call center	Nil	
[Disallowance for short-deduction of tax at source would **not** be attracted since the tax@2% deductible at source in respect of payment of service charges to call center, has been fully deducted]		
(iii) CSR Expenditure incurred	8,00,000	
[As per Explanation 2 to section 37, CSR expenditure incurred by the company as per the Companies Act, 2013 is not deemed to be an expenditure incurred by the company for the purposes of business or profession. Hence, the same is not allowable as deduction. Since the same has been debited to statement of profit and loss, it has to be added back]		
(v) Cash payment in excess of ₹ 10,000 in a day	2,00,000	
[Disallowance is attracted in respect of expenditure, for which payment exceeding ₹ 10,000 in a day has been made in cash. Since such expenditure is debited to the statement of profit and loss, the same has to be added back, as per section 40A(3)]		
(vii) Provision for deferred tax	6,50,000	
[Deferred tax is an accounting concept and there is no provision in the Income-tax Act, 1961 permitting deduction in respect of the same. Therefore, provision for deferred tax is not an allowable deduction while computing business income. Since the same has been debited to the statement of profit and loss, it has to be added back for computing business income]		16,50,000
		68,50,000
Add: Income taxable but not credited to statement of profit and loss		
(a) Retention money		**3,00,000**
[ICDS III requires recognition of contract revenue, including retention money, on percentage of completion method.		

In this case, since the question mentions that the assessee executed the contract of the value of ₹ 15 lakhs, it is logical to assume that 100% of the contract has been completed this year. Therefore, the entire retention money of ₹ 3 lakhs has to be recognized in the P.Y.2019-20, since the contract has been fully completed]. **Note** – Since the question also states that the retention money of ₹ 3 lakhs (20% of ₹ 15 lakhs) would be realised after two years, it is possible to assume that the contract is yet to be completed, in which case only 50% of the said sum has to be recognized in the P.Y. 2019-20 on percentage of completion method. If this view is taken, only ₹ 1.5 lakhs has to be recognized as income in the P.Y. 2019-20.		
		71,50,000
Less: Items credited to statement of profit and loss, but not includible in business income	9,50,000	
(i) Share income from partnership firm ABC & Co. [Share income from firm is exempt in the hands of the partner u/s 10(2A). Since the company is a partner in a firm, the share of its income in the firm would be exempt. Since the same has been credited to statement of profit and loss, it has to be reduced to compute business income]		
(iv) Grant received from State Government for acquisition of generator [Grant received from the Government, other than a grant which is taken into account for determination of actual cost of the asset, is included in the definition of income. In this case, as per ICDS VII, since the grant is received for acquisition of generator, the same has to be adjusted in actual cost. As the same has been credited to the statement of profit and loss, it has to be reduced to compute business income]	10,00,000	
(viii) Cessation of a trading liability [Remission or cessation of a trading liability, allowed as deduction in an earlier previous year, would be deemed as income in the year of remission or cessation, as per section 41(1)(a). Since the amount of ₹ 5 lakhs has already been credited to statement of profit and loss, no further adjustment is required]	Nil	
(**ix) Royalty income in respect of patents chargeable under section 115BBF** [Royalty income in respect of patents chargeable under section 115BBF can be treated as business income or income from other sources, depending upon the facts of the case. In this case, since the question mentions that BG (P) Ltd. is engaged in multiple businesses, it is logical to assume that the same is in the nature of business income. Since the amount of ₹ 12 lakh has already been credited to statement of profit and loss, no further adjustment is necessary]	Nil	
		19,50,000
		52,00,000
Less: **Depreciation**		
Depreciation under section 32	12,25,000	

Less: Depreciation@15% on ₹ 15 lakhs, being amount paid in cash for generator and the amount of grant, not includible in actual cost as per second proviso to section 43(1) and ICDS VII on Government Grants.	2,25,000	
Depreciation allowable under the Income-tax Act, 1961	10,00,000	**Nil**
Less: Depreciation debited to books of account	10,00,000	
Profits and gains from business and profession		52,00,000
Income from Other Sources		
Consideration received in excess of FMV of equity shares [(₹ 25 **(-)** ₹17) x 1,00,000 equity shares]		8,00,000
[BG (P) Ltd., a company in which public are not substantially interested has issued equity shares at a premium. In this case, the difference between consideration and the FMV of shares is taxable as "Income from Other Sources"].		
Total Income		**60,00,000**

Question 43

SDK Ltd. is engaged in the manufacture of textile since 01-04-2012. Its Statement of Profit and Loss for the previous year ended 31st March, 2020 shows a profit of ₹ 600 lakhs after debiting or crediting the following items:

(i) Depreciation charged on the basis of useful life of assets as per Companies Act is ₹ 40 Lakhs.

(ii) Industrial power tariff concession of ₹ 3.5 Lakhs, received from State Government was credited to P & L Account.

(iii) The company had provided ₹ 25 Lakhs being sum fairly estimated as payable with reasonable certainty, to workers on agreement to be entered with the workers union towards periodical wage revision once in every three years.

(iv) Dividend received from a foreign company ₹ 10 Lakhs.

(v) Loss ₹ 25 Lakhs, due to destruction of a machine worth ₹ 30 Lakhs by fire due to short circuit and ₹ 5 Lakh received as scrap value. The insurance company did not admit the claim of the company on charge of gross negligence.

(vi) Provision for gratuity based on actuarial valuation was ₹ 400 Lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 275 lakhs.

(vii) The company has purchased 500 tons of industrial paper as packing material at a price of ₹ 30,000 per ton from M/s. Shivbramha, a firm in which majority of the directors of SDK Ltd. are partners. The firm's normal selling price of the same material in market is ₹ 28,000 per ton.

(viii) Advertisement charges ₹ 1.5 Lakhs, paid by cheque for advertisement published in the souvenir of a political party registered with the Election Commission of India.

(ix) Long term capital gain ₹ 0.5 Lakhs on sale of equity shares on which Securities Transaction Tax (STT) was paid at the time of acquisition and sale.

Additional Information:

(i) Normal depreciation as per Income-tax Rules is ₹ 65 Lakhs.

(ii) The sales tax ₹ 11 Lakhs collected from its customers was paid by the company on the due dates. On an appeal, the High Court directed the sales tax department to refund ₹ 4 Lakhs to

the company. The company in turn refunded ₹ 3 lakhs to the customers from whom it was collected and the balance ₹ 1 lakh is still lying under the head "Current Liabilities".

Compute the total income of SDK Ltd. for the A.Y. 2020-21 by analyzing and applying the relevant provisions of income-tax law. Briefly explain the reasons for treatment of each item. Ignore the provisions relating to Minimum Alternate Tax.

Answer

Computation of Total Income of SDK Ltd. for the A.Y. 2020-21

	Particulars	Amount (₹)	
I	**Profits and gains of business and profession**		
	Net profit as per the statement of profit and loss		6,00,00,000
	Add: Items debited but to be considered separately or items of expenditure to be disallowed		
	(i) **Depreciation as per Companies Act**	40,00,000	
	(iii) **Provision for wages payable to workers**	-	
	[Since the provision is based on a fair estimate of wages payable with reasonable certainty, the provision is allowable as deduction. ICDS X requires a reliable estimate of the amount of obligation and 'reasonable certainty' for recognition of a provision, which is present in this case. As the provision of ₹ 25 lakhs has been debited to statement of profit and loss, no adjustment is required while computing business income]		
	(v) **Loss due to destruction of machinery by fire**	25,00,000	
	[Loss of ₹ 25 lakhs due to destruction of machinery caused by fire is not deductible since it is capital in nature. Since the loss has been debited to statement of profit and loss, the same is required to added back while computing business income]		
	(vi) **Provision for gratuity**	1,25,00,000	
	[Provision of ₹ 400 lakhs for gratuity based on actuarial valuation is not allowable as deduction. However, actual gratuity of ₹ 275 lakhs paid is allowable as deduction. Hence, the difference has to be added back to income [₹ 400 lakhs (-) ₹275 lakhs]		
	(vii) **Purchase of paper at a price higher than the fair market value**	10,00,000	
	[Since the purchase is from a related party, a firm in which majority of the directors of the company are partners, at a price higher than the fair market value, the difference between the purchase price (₹ 30,000 per ton) and the fair market value (₹ 28,000 per ton) multiplied by the quantity purchased (500 tons, i.e.,[₹ 2,000 x 500) has to be added back]		

	(viii) **Advertisement in souvenir of a political party** [Advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company. Since, the expenditure has been debited to statement of profit and loss, the same has to be added back while computing business income]	1,50,000	2,01,50,000
			8,01,50,000
	Add: Income taxable but not credited to statement of profit and loss		
	AI(ii) **Sales tax not refunded to customers out of sales tax refund** [The amount of sales tax refunded to the company by the Government is a revenue receipt chargeable to tax. Out of the refunded amount of ₹ 4 lakhs, the amount of ₹ 3 lakh stands refunded to customers would not be chargeable to tax.. The balance amount of ₹ 1,00,000 lying with the company would be chargeable to tax]		1,00,000
			8,02,50,000
	Less: Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances		
	(ii) **Industrial power tariff concession received from State Government** [Any assistance in the form of, inter alia, concession received from the Central or State Government would be treated as income. Since the same has been credited to statement of profit and loss, no adjustment is required]	-	
	(iv) **Dividend received from foreign company** [Dividend received from foreign company is taxable under "Income from other sources". Since the said same has been credited to the statement of profit and loss, it has to be deducted while computing business income]	10,00,000	
	(v) **Scrap value of machinery** [Scrap value of machinery, being capital in nature, has to be reduced from WDV of machinery. Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]	5,00,000	
	(ix) **Long term capital gains of sale of equity shares** [The taxability or otherwise of long term capital gain on sale of equity shares has to be considered while computing income under the head "Capital Gains". Since such capital gains has been credited to statement of profit and loss, the same has to be reduced to arrive at the business income.]	50,000	
	AI(i) **Depreciation as per Income-tax Rules, 1961 [See Note below]**	65,00,000	80,50,000

	Profits and gains from business and profession		**7,22,00,000**
II	**Income from Other Sources**		
	Dividend received from foreign company		10,00,000
	[Dividend received from a foreign company is chargeable to tax under the head" Income from other sources"]		
III	**Capital Gains**		
	Long term capital gain on sale of equity shares		**50,000**
	[Long term capital gains on sale of equity shares on which STT is paid at the time of acquisition and sale is not taxable upto Rs. 1 lakh under section 112A. However, it will become part of total income.]		
	Gross Total Income		**7,32,50,000**
	Less: Deduction under Chapter VI-A		
	Under section 80GGB [Contribution by a company to a registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in souvenir published by such political party tantamounts to contribution to such political party.]		1,50,000
	Total Income		**7,31,00,000**

Note – As per section 43(6)(c), for computation of written down value (WDV) of a block of asset at the end of the year, the amount of scrap value received has to be reduced from the value of block of assets at the beginning of the previous year and cost of assets purchased during the year. Depreciation is calculated on the value so arrived of the block of asset as on 31.3.2020. In the question, adjustment (v) states that scrap value of ₹ 5 lakh is received in respect of destroyed machinery and same is credited in the statement of profit and loss. In the additional information, since, depreciation as per Income-tax Rules, 1962 is given, no further adjustment for scrap value is done, presuming that the same has already been reduced and depreciation has been calculated on the value so arrived at of the block as on 31.3.2020.

However, since scrap value has been credited to the statement of profit and loss, it is possible to take a view that the amount of scrap value is not reduced while computing the value of the assets. In such a case, depreciation allowable would be ₹ 64,25,000 [i.e., ₹ 65,00,000 – ₹ 75,000, being 15% of ₹ 5,00,000]. The business income and total income would be ₹ 7,18,75,000 and ₹ 7,27,25,000, respectively.

Question 44

M/s. Gomati P Ltd., a closely held company, is in the business of growing rubber. The profit & loss account for the year ended 31-03-2020 of the company shows a net profit ₹ 37.65 crores after debiting depreciation of ₹ 30 crores.

The company has provided the following additional information:

(i) The company has deposited ₹ 30 crores in a special account with NABARD on 29- 04-2020.

(ii) The company has brought forward losses of ₹ 6 crores pertaining to Assessment Year 2017-18. Mr. A who continuously held 60% of shares carrying voting power since incorporation of the company, had sold his entire holding to Mr. B on 01-08-2019.

(iii) The company had an accumulated balance of ₹ 200 crores in the special account with NABARD as on 01-04-2019. It has withdrawn ₹ 40 crores and utilized the same for the following purposes:

- Purchase of a new sprinkling machine for use in its operation ₹ 10 crores,
- Purchase of office appliances for corporate office at Chennai ₹ 10 crores.
- Purchase of computers and accessories ₹ 5 crores.
- Construction of a godown at a cost of ₹ 1 crore near the rubber estate to store raw rubber.
- Repairs to machinery ₹ 35 lakhs.

(iv) On 31·03·2020, the company has sold machinery which was purchased on 10·05·2011 for ₹ 10 crores. The purchase of the said machinery was in accordance with the scheme of deposit.

(v) Depreciation allowable as per Tax Audit Report is ₹ 28 crores.

Compute Taxable and Exempt income of M/s. Gomati (P) Ltd.

Answer

Computation of Taxable and Exempt Income of M/s Gomati (P) Ltd. for the A.Y. 2020-21

Particulars		₹
Net profit as per Profit and Loss Account		37,65,00,000
Add: **Excess depreciation as per books of account**	₹	
Depreciation as per books of account	30,00,00,000	
Less: Depreciation allowable as per the Income-tax Act, 1961	28,00,00,000	2,00,00,000
Net profit before allowing deduction under section 33AB		39,65,00,000
Less: Deduction under section 33AB would be the lower of:		
- **Amount deposited in Rubber Development Account** on or before 30.9.2020 [i.e., ₹30,00,00,000]		
- **40% of profits of such business** [i.e., ₹ 15,86,00,000, being 40% of ₹ 39,65,00,000]		15,86,00,000
Net profit after allowing deduction under section 33AB		**23,79,00,000**
Add: Amount withdrawn from special account with NABARD, which is deemed as profits and gains of business or profession		
(i) **Purchase of a new sprinkling machine for use in its operation for ₹ 10 crores,** would **not** be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme.		Nil
(ii) **Purchase of office appliances for corporate office at Chennai for ₹ 10 crores,** out of the amount withdrawn from the deposit account, would be deemed as profits and gains of business or profession, since the said utilisation is not permissible.		10,00,00,000
(iii) **₹ 5 crores utilised for purchase of computers and accessories is permissible.** Thus, such amount would **not** be deemed as profits and gains of business or profession.		Nil
(iv) **₹ 1 crore utilised for construction of a godown near rubber estate to store raw rubber,** would **not** be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme.		Nil

(v) **₹ 35 lakhs utilised for repairs to machinery** would not be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme. **Note** - However, no deduction would be allowed in respect of such expenditure mentioned in (i), (iii), (iv) and (v) during the P.Y. 2019-20, since amount is spent out of the amount deposited in special account with NABARD, which has already been allowed as deduction in an earlier assessment year.	Nil
(vi) The **remaining amount of ₹ 13.65 crores {₹ 40 crores less ₹ 26.35 crores** [utilised above in **(i) to (v)]}**, which is **not** utilised during the previous year in which such amount is withdrawn, would be deemed as profits and gains of business or profession**.**	13,65,00,000
Add: Sale of machinery acquired out of the amount withdrawn from special account in accordance with the scheme of deposit. The cost of such machinery would be deemed as profits and gains of business or profession, since such machinery is sold before the expiry of eight years from the end of the previous year of its acquisition. **[See Note at the end of the solution]**	10,00,00,000
Total Composite business profits	**57,44,00,000**
Less: 65% of ₹ 57,44,00,000, being agricultural income exempt	37,33,60,000
Business income	**20,10,40,000**
Less: Brought forward business loss of ₹ 6 crores pertaining to A.Y.2017-18 not allowed to be set-off against the business profits of the P.Y. 2019-20, since as on 31.3.2020, the shares of M/s Gomati P Ltd carrying 60% (i.e., not less than 51%) of the voting power is held by Mr. B and not by Mr. A, being the person who held such shares as on 31.03.2017, being the last day of previous year 2016-17, in which such loss was incurred.	-
Business income chargeable to tax	**20,10,40,000**

Note – As per section 33AB(5), the cost of the asset acquired would be deemed as profits of the year in which it is sold, only if the sale takes place **before** the expiry of eight years from the end of the previous year in which it was acquired. In this case the asset was acquired in the P.Y.2011-12. The eight year period from the end of P.Y.2011-12 would expire on 31.3.2020. As per the plain reading of section 33AB(5), if the sale takes place before 31.3.2020, the cost of asset would be deemed as profits of the previous year of sale. However, in this case, the sale took place exactly on 31.3.2020 and not before 31.3.2020. Therefore, it is possible to take a view that the deeming provision would not apply in this case. If this alternate view is taken, total composite business profits would be ₹ 47,44,00,000. Agricultural income would be ₹ 30,83,60,000 and business income chargeable to tax would be ₹ 16,60,40,000.

Question 45

Ms. Janani reports to you that her gross receipt from interior decoration profession carried on by her during the year ended 31-03-2020 is ₹ 47,80,000. Her net income as per income and expenditure account is ₹ 25,00,000 before adjustment of depreciation of ₹ 1,50,000. She did not pay any amount by way of advance tax during the financial year 2019-20. She has two residential house properties, of which one is self-occupied for residence and another is let out for the monthly rent of ₹ 15,000 during the financial year 2019-20.

Is Janani eligible to opt for presumptive tax provisions, if any, under the Income-tax Act, 1961? If so, is it beneficial for her to opt for such provisions? Advise, assuming that she approached you for consulting on this matter in April, 2020.

Answer

Since gross receipts of ₹ 47,80,000 of Ms. Janani from interior decoration profession carried on by her is less than ₹ 50,00,000, she can opt for presumptive tax provisions under section 44ADA.

In such a case, her income from interior decoration profession would be ₹ 23,90,000, being 50% of ₹ 47,80,000. Since all deductions allowable under sections 30 to 38 are deemed to have been given full effect to, no deduction in respect of depreciation would be allowable from the income computed on presumptive basis under section 44ADA.

I. Where Ms. Janani declares income from profession on presumptive basis u/s 44ADA

Computation of total income of Ms. Janani		
Particulars	**₹**	**₹**
Income from house property		
Self-occupied property	Nil	
Let-out Property:		
Annual Value [₹ 15,000 x 12]	1,80,000	
Less: Deduction u/s 24 [30% of ₹ 1,80,000]	54,000	1,26,000
Profits and gains from business or profession		
Income from interior decoration profession [50% of ₹ 47,80,000]		23,90,000
Total Income		**25,16,000**
Computation of tax liability of Ms. Janani		
Particulars		**₹**
Tax on total income = [30% of ₹ 15,16,000 (₹ 25,16,000 – ₹10,00,000) + ₹ 1,12,500]		5,67,300
Add: Health and education cess@4%		22,692
Total tax liability		**5,89,992**
Add: Interest under section 234B [1% of ₹ 5,89,900]		5,899
Interest under section 234C [1% of ₹ 5,89,900, since the advance tax liability has to be paid in one instalment on or before 15.3.2020]		5,899
Total tax and interest liability		**6,01,790**
Ms. Janani can, however, declare lower profits than the presumptive profits of ₹ 23,90,000, if she maintains books of accounts under section 44AA and gets the same audited under section 44AB. In such case, she can file return on or before 30.9.2020.		

Where Ms. Janani declares income from profession as per books of account

Computation of total income of Ms. Janani

Particulars	**₹**	**₹**
Income from house property		
Self-occupied property	Nil	
Let-out property:		
Annual Value [₹ 15,000 x 12]	1,80,000	
Less: Deduction u/s 24 [30% of ₹ 1,80,000]	54,000	1,26,000
Profits and gains from business or profession		

Income from interior decoration profession [₹ 25,00,000 – ₹ 1,50,000]		23,50,000
Total Income		**24,76,000**
Computation of tax liability:		
Tax on total income = [30% of ₹ 14,76,000 (₹ 24,76,000 – ₹ 10,00,000) + ₹ 1,12,500]		5,55,300
Add: Health and education cess@4%		22,212
Total tax liability		**5,77,512**
Add: Interest under section 234B [1% of ₹ 5,77,500]		5,775
Interest under section 234C **[See Working Note below]**		29,164
Total tax and interest liability		**6,12,451**
Total tax and interest liability (rounded off)		**6,12,450**

Although the income from profession computed as per books of account is lower than the income from profession computed on presumptive basis under section 44ADA, however, the cumulative tax and interest liability would be higher by ₹ 10,660 (i.e., ₹ 6,12,450 - ₹ 6,01,790) in case of the former. Therefore, Ms. Janani should opt to declare income on presumptive basis under section 44ADA, in which case, she has to file her return of income on or before 31st July, 2020.

Working Note: Computation of interest under section 234C

Date	Advance tax payable till date	Short-fall	Rate of interest [1% per month]	Interest
		(₹)		(₹)
15.06.2019	15%	86,625	3% [1% x 3]	2,599
15.09.2019	45%	2,59,875	3% [1% x 3]	7,796
15.12.2019	75%	4,33,125	3% [1% x 3]	12,994
15.03.2020	100%	5,77,500	1%	5,775
				29,164

Note – The above solution has been worked out by considering that Ms. Janani pays the advance tax required to be paid in April, 2020 itself, after consulting the tax advisor in the month of April, 2020.

Question 46

Statement of Profit and Loss account of BAS Industries Ltd. engaged in production and marketing of diversified products, shows a net profit (before tax) of ₹ 72,00,000 for the financial year ended 31st March, 2020 after charge of the following items :

A : Items debited to the Statement of Profit and Loss:

(i) Depreciation as per Companies Act, 2013: ₹ 24,00,000

(ii) Interest amounting to ₹ 60,000 for short payment of advance tax paid as per section 234B relating to the assessment year 2018-19.

(iii) Interest and borrowing costs amounting to ₹ 9,50,000 and ₹ 7,00,000 though not meeting the criteria for recognition as a component of cost, included in cost of opening and closing inventory, respectively.

(iv) Expenditure of ₹ 41,000 paid in cash comprising of ₹ 22,000 directly paid to producer of dairy farming products and ₹ 19,000 paid towards printing and stationery items to a trader.

(v) ₹ 3,50,000 paid to a contractor for carrying out repair work at factory premises. Tax was not

deducted at source on this payment.

(vi) ₹ 35,000 towards expenditure for earning income from transfer of carbon credits.

(vii) Contribution to electoral trust: ₹ 3,00,000 paid by way of cheque.

(viii) Expenditure towards advertising charges in a brochure of a political party registered under section 29A of Representation of People Act, 1951: ₹ 40,000 paid by way of cheque.

(ix) Interest on term loans obtained from Cooperative Bank not paid before the due date of filing of return of income (due date being 30.09.2020): ₹ 2,60,000

(x) Actual contribution to the pension scheme of employees: ₹ 1,50,000

B: Items credited to the Statement of Profit and Loss:

(i) Unrealised rent of ₹ 3,80,000 pertaining to financial year 2016-17 & 2017-18 recovered during the year in respect of a commercial property owned by the company, which was sold by the company on 23.03.2019.

(ii) Dividends from a specified foreign company including the expenditure of ₹ 20,000 incurred on earning such dividends : ₹ 1,60,000

(iii) Profit of ₹ 3,00,000 received from hedging contract entered into for meeting out loss in foreign currency payments towards an imported printing machinery valued at ₹ 95 lakhs, installed on 15th December, 2019 and put to use from that date.

(iv) Interest from banks on fixed deposits net of TDS at 10% : ₹ 1,35,000

Additional Information:

(1) Depreciation as per Income-tax Rules: ₹ 28,00,000 exclusive of depreciation on the imported printing machine referred to in item B (iii)

(2) Expenditure pertaining to previous financial year allowed on due basis, but paid in current financial year in cash on 18.01.2020: ₹ 35,000

(3) Audit fee for the previous year 2018-19: ₹ 75,000. TDS deducted but not paid in the relevant previous year. However, TDS was paid on 31.12.2019.

(4) Income from transfer of Carbon Credits amounting to ₹ 4,00,000 included in Net Profit (before tax).

(5) The eligible salary and dearness allowance for the pension scheme referred to under section 80CCD is ₹ 10,00,000.

Compute the total income of BAS Industries Ltd., for assessment year 2020-21. Give brief reasons for the treatment given to each of the items taken into consideration in computation of income of the company.

Answer

Computation of Total Income of BAS Industries Ltd. for the A.Y. 2020-21

Particulars	Amount (₹)		
Income from house property			
Unrealised rent [Taxable under section 25A, even if BAS Industries Ltd. is no longer the owner of commercial property]		3,80,000	
Less: 30% of above		1,14,000	2,66,000

Profits and gains of business and profession			
Net profit as per the statement of profit and loss		72,00,000	
Add: Items debited but to be considered separately or to be disallowed			
(i) Depreciation as per Companies Act, 2013	24,00,000		
(ii) **Interest under section 234B for short payment of advance tax** [Any interest payable for default committed by assessee for discharging his statutory obligations under Income-tax Act, 1961 which is calculated with reference to the tax on income is not allowable as deduction under section 40(a)(ii). Since the same has been debited to statement of profit and loss, it has to be added back]	60,000		
(iii) **Interest and borrowing cost included in Opening and Closing inventory** [As per ICDS II, Interest and borrowing cost which does not meet the criteria for recognition as a component of the cost, cannot be included in the cost of inventory. Since the same have been included in the opening and closing inventory, the difference between ₹ 9,50,000, being interest included in opening inventory – ₹ 7,00,000, being interest included in closing inventory, has to be added back]	2,50,000		
(iv) **Cash payment in excess of ₹ 10,000** [Disallowance u/s 40A(3) is attracted in respect of expenditure, for which payment exceeding ₹10,000 in a day has been made in cash. Since expenditure of ₹19,000 towards printing and stationery items is debited to the statement of profit and loss, the same has to be added back. However, payment of ₹ 22,000 to producer for dairy farming products is not disallowed since it is covered under the exceptions specified in Rule 6DD]	19,000		
(v) **Repair work paid to contractor without deduction of tax at source** [Disallowance of 30% of the amount of ₹ 3,50,000 paid for carrying out repair work to a contractor without deduction of tax at source would be attracted u/s 40(a)(ia)]	1,05,000		
(vi) **Expenditure for transfer of carbon credits** [Income by way of transfer of Carbon Credits is chargeable to tax under section 115BBG at a flat rate. No deduction is allowed under any provision of the Act in respect of any expenditure or allowance in relation thereto. Since such expenditure is debited to the statement of profit and loss, the same has to be added back]	35,000		

(vii) **Contribution to electoral trust** [Contribution to electoral trust is not allowable as deduction while computing business profits of the company. Since the contribution has been debited to statement of profit and loss, the same has to be added back while computing business income]	3,00,000		
(viii) **Advertisement in brochure of a political party** [Advertisement charges paid in respect of brochure published by a political party is not allowable as deduction from business profits of the company as per section 37(2B). Since the expenditure has been debited to statement of profit and loss, the same has to be added back while computingbusiness income]	40,000		
(ix) **Interest to co-operative bank not paid before 30.9.2018** [Disallowance under section 43B would be attracted for A.Y.2018-19, since the interest was not paid on or before the due date of filing of return]	2,60,000		
(x) **Contribution towards pension scheme of employees** [Contribution towards pension scheme, referred to in section 80CCD, of employees is allowed only to the extent of 10% of salary of the employee in the P.Y. i.e., ₹1,00,000 being 10% of ₹ 10,00,000. Therefore, the excess contribution of ₹ 50,000 [i.e., ₹ 1,50,000 – ₹ 1,00,000] is disallowed under section 36(1)(iva).	50,000		
		35,19,000	
		1,07,19,000	
Add: Amount taxable but not credited to statement of profit and loss			
A(2) Expenditure pertaining to previous financial year [Cash payment in excess of ₹10,000 made in the current year in respect of expenditure allowed on mercantile basis in the previous year, would be deemed as income in the current year.]		35,000	
		1,07,54,000	
Less: Items credited to statement of profit and loss, but not includible in business income / permissible expenditure and allowances			
(i) Unrealised rent [Unrealised rent in respect of commercial	3,80,000		

property is taxable under the head "Income for house property". Since the said rent has been credited to the statement of profit and loss, the same has to be deducted while computing business income]			
(ii) Dividend received from specified foreign company [Dividend received from specified foreign company is taxable under the head "Income from other sources". Since the said dividend has been credited to the statement of profit and loss, the same has to be deducted while computing business income] **Note:** Since the question does not list the expenditure of ₹ 20,000 incurred on earning dividend income under "A. Items debited to the Statement of Profit and Loss", such expenditure has not been added back.	1,60,000		
(iii) Profit from hedging contract [Hedging contract is entered into for safeguarding against any loss that may arise due to currency fluctuation. The profit from such contract entered into for meeting loss in foreign currency payments towards imported printing machinery has to be adjusted against the cost of machinery. Since the said profit has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	3,00,000		
(iv) Interest from bank fixed deposit [Interest on fixed deposit is taxable under "Income from Other Sources". Since the said interest has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	1,35,000		
A(3) Audit fees of P.Y. 2018-19 [30% of ₹ 75,000, being the audit fees disallowed in the P.Y. for non-remittance of TDS on or before due date of filing for P.Y. 2018-19 would be allowed in the year of payment of TDS i.e., P.Y. 2019-20]	22,500		
A(4) Transfer of Carbon Credits chargeable to tax under section 115BBG [Income by way of transfer of Carbon Credits chargeable under section 115BBG can be treated as business income or income from other sources, depending upon the facts of the case. In this case, since the question mentions that BAS Industries Ltd. is engaged in production and marketing of diversified products, it is logical to assume that the same is in the nature of business income. Since the amount of ₹ 4 lakh has already been credited to statement of profit and loss, no further adjustment is necessary]	Nil		
		9,97,500	
		97,56,500	
Less: **Depreciation as per Income tax Rules**			

A(1) Depreciation under section 32	28,00,000		
Add: Depreciation @7.5% on ₹ 92 lakhs [₹ 95 lakhs, being imported printing machinery - ₹ 3 lakhs, being profit from hedging contract] since, machinery is put to use for less than 180 days].	6,90,000		
Add: Additional depreciation@10% on ₹ 92 lakhs, since, machinery is put to use for less than 180 days assuming the conditions for claim of additional depreciation are satisfied .	9,20,000		
		44,10,000	
Profits and gains from business or profession			**53,46,500**
Income from Other Sources			
Dividend from specified foreign company		1,60,000	
[No deduction is allowable in respect of expenditure incurred on earning dividends]			
Interest from banks on fixed deposits (Gross)			
[Interest on banks on fixed deposits is taxable as "Income from other sources"] [₹1,35,000 x 100/90]		1,50,000	**3,10,000**
Gross Total Income			**59,22,500**
Less: Deduction under Chapter VI-A			
Under section 80GGB [Contribution by a company to an electoral trust and registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in brochure published by political party tantamount to contribution to such political party] [₹ 3,00,000 + ₹ 40,000]			3,40,000
Total income			**55,82,500**

Question 47

Rhombus (P) Limited is engaged in manufacture and sale of ceramic tiles. The net profit of the company as per its profit and loss account for the year ended 31st March, 2020 is ₹ 210 lakh after debiting or crediting the following items:

(i) One-time license fee of ₹ 32 lakh paid to ABC Ltd (an Indian company) for obtaining franchise on 1st June, 2019.

(ii) ₹ 32,000 paid to Beta & Co., a goods transport operator, in cash on 31st January, 2020 for carrying company's products to the warehouse.

(iii) Rent of ₹ 50,000 p.m. received from letting out a part of its office premises. Municipal tax in respect of the said part of the building is ₹ 8,000 remains unpaid due to court litigation.

(iv) ₹ 1 lakh, being contribution to a scientific research association approved and notified under section 35(1)(ii).

(v) ₹ 2 lakh, being loss due to destruction of a machinery caused by a fire due to short circuit. The Insurance Company did not admit the claim of the company.

(vi) ₹ 5 lakh paid to a contractor for repair work at the company's factory. No tax was deducted on such payment.

(vii) Dividend of ₹ 10,000 from Gama Limited on 1,000 equity shares of ₹ 10 each purchased at ₹ 100 per share on 10th October, 2019. The rate of dividend declared is 100%, the record date being 10th December, 2019. The shares were sold on 1st March, 2020 at ₹ 80 per share.

(viii) Depreciation on tangible fixed assets as per books of account ₹ 2.20 lakh.

Additional Information:

(i) Depreciation on tangible fixed assets as per Income-tax Rules ₹ 2.60 lakh.

(ii) The company has obtained a loan of ₹ 2 lakh from Theta Private Limited in which it holds 16% voting rights. The accumulated profits held by Theta Private Limited on the date of loan were ₹ 0.50 lakh.

Compute total income of Rhombus (P) Ltd. for the Assessment Year 2020-21 indicating reasons for treatment of each item. Ignore the provisions relating to minimum alternate tax.

Answer

Computation of total income of Rhombus (P) Ltd. for the A.Y. 2020-21

Particulars	₹	₹
Income from House Property (Note 1)		
Gross Annual Value (GAV) (Rental income has been taken as GAV in the absence of other information) [₹ 50,000 x 12]	6,00,000	
Less: Municipal taxes (not deductible since it has not been paid)	Nil	
Net Annual Value (NAV)	6,00,000	
Less: Deduction under section 24 (30% of NAV)	1,80,000	4,20,000
Profits and gains of business or profession		
Net profit as per profit and loss account	2,10,00,000	
Add: Licence fee for obtaining franchise **(Note 2)**	32,00,000	
Municipal taxes in respect of let-out part of office premises **(Note 1)**	8,000	
Contribution to approved and notified scientific research association (treated separately) **(Note 4)**	1,00,000	
Loss due to destruction of machinery by fire **(Note 5)**	2,00,000	
Amount paid to contractor without deduction of tax at source [₹5 lakhs x 30%] **(Note 6)**	1,50,000	
Short-term capital loss on sale of shares of Gama Ltd. **(Note 7)**	20,000	
Depreciation on tangible fixed assets **(Note 8)**	2,20,000	
	2,48,98,000	
Less: Depreciation under section 32 **(Note 8)**		
Tangible fixed assets **(Note 8)** 2,60,000		
Intangible asset (Franchise) 25% of ₹ 32,00,000 **(Note 2)** 8,00,000	10,60,000	
Weighted deduction under section 35(1)(ii) **(Note 4)**		
₹ 1,00,000 x 150% (Contribution of scientific research association)	1,50,000	
Rental income to be taxed under "Income from house property" **(Note 1)**	6,00,000	

Dividend credited to profit and loss account to be excluded **(Note 7)**	10,000	
		2,30,78,000
Capital Gains (Note 7)		
Short-term capital loss (₹ 20 x 1000 shares)	20,000	
Less: Dividend exempt under section 10(34)	10,000	
Short-term capital loss to be carried forward to A.Y. 2021-22	10,000	
Income from Other Sources (Note 9)		
Deemed dividend under section 2(22)(e) subject to DDT in the hands of Theta (P) Ltd.		-
Total Income		**2,34,98,000**

Notes:

(1) Rental income from letting out a part of the office premises is taxable under "Income from house property". Therefore, it has to be deducted while calculating business income, since the income has been credited to profit and loss account. Likewise, municipal taxes due in respect of such property, debited to profit and loss account has to be added back to compute business income.

(2) Franchise is an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of ₹ 32 lakh paid for obtaining franchise has been debited to profit and loss account, the same has to be added back. Depreciation @ 25% has to be provided in respect of the intangible asset since it has been used for more than 180 days during the year.

(3) ₹ 32,000 paid to Beta & Co., a goods transport operator in cash is deductible while computing business income, as the limit for disallowance under section 40A(3) would be attracted in case of payment to a transport contractor only when it exceeds ₹ 35,000. Since it is already debited to profit and loss account, no further adjustment is required.

(4) Contribution to a scientific research association approved and notified under section 35(1)(ii) is eligible for a weighted deduction of 150%. Therefore, the contribution of ₹ 1,00,000 debited to profit and loss account has been added back and ₹ 1,50,000 (being 150% of ₹ 1,00,000) has been deducted while computing business income.

(5) Loss of ₹ 2 lakh due to destruction of machinery caused by fire is not deductible since it is capital in nature.

(6) Payment to contractor without deduction of tax at source would attract disallowance at 30% of the expenditure under section 40(a)(ia).

(7) As per section 94(7), where any person buys any shares within 3 months prior to the record date and sells such shares within 3 months after such date and the dividend received on such shares is exempt, then, the loss arising out of such purchase and sale of shares shall be ignored to the extent of dividend income.

	₹
Loss on sale of shares (₹ 100 - ₹ 80) x 1000 shares	20,000
Less: Dividend exempt under section 10(34)	10,000
Short-term capital loss	10,000

Since short term capital loss can be set-off only against income under the head "Capital Gains", the short-term capital loss of ₹ 10,000 has to be carried forward to the next year. Dividend of ₹ 10,000 credited to profit and loss account has to be deducted and short-term capital loss of ₹ 20,000 debited to profit and loss account has to be added back.

(8) Depreciation as per Income-tax Rules, 1962, is deductible while calculating business income. Therefore, ₹ 2.60 lakh depreciation on tangible fixed assets and ₹ 8 lakh on intangible assets is deducted. The amount of ₹ 2.20 lakh depreciation debited to profit and loss account as

per books of account has been added back.

(9) As per section 2(22)(e), any payment by a company in which the public are not substantially interested by way of loan to a shareholder, who is the beneficial owner of shares holding not less than 10% of voting power, is deemed as dividend to the extent to which to company possesses accumulated profits. Accordingly, in this case, ₹ 50,000 would be deemed as dividend under section 2(22)(e) and subject to dividend distribution tax @30% (plus surcharge @12% and health and education cess @4%) in the hands of Theta (P) Ltd. Hence, such dividend is exempt in the hands of Rhombus (P) Ltd. under section 10(34).

Question 48

Sankar Ltd, engaged in the manufacture of footwear and leather products, for the past 8 years, reported a net profit of ₹ 272 lakhs as per the statement of profit and loss for the year ended 31st March, 2020. The company was subject to tax audit under section 44AB of the Income-tax Act, 1961. The net profit is arrived at after debiting or crediting the following amounts:

(i) Depreciation charged on the basis of useful life of assets as per Companies Act is ₹ 32 lakhs.

(ii) A sundry creditor whose amount of ₹ 32 lakhs was outstanding since long time, has been settled for ₹ 26 lakhs on 31st March, 2020 based on compromise settlement. The amount waived has been credited to the statement of profit and loss.

(iii) Employers' contribution to EPF of ₹ 3 lakhs for the month of March, 2020 was deposited on 29th July, 2020.

(iv) Interest payments debited ₹ 30 lakhs (Includes interest on term loan of ₹ 25 lakhs availed on 1-4-2019 at interest rate of 12% p.a towards purchase of machinery during the year).

(v) Payment of ₹ 30 lakhs to A & Co., a subcontractor, for processing raw leather without deduction of tax is debited to statement of profit & loss. This amount includes ₹ 20 lakhs for purchase of chemicals and ₹ 10 lakhs towards labour charges which is separately shown in bills submitted.

Additional Information:

(1) The company has not made provision for an amount of ₹ 12 lakhs being a fair estimate of the amount as payable to workers towards periodical wage revision once in 3 years in respect of existing employees. The provision is estimated on a reasonable certainty of the revision once in 3 years.

(2) The written down values of assets before allowing depreciation as per Income-tax Rules are as under:

Factory Buildings:	₹ 180 lakhs;
Plant & Machinery	₹ 170 lakhs (inclusive of ₹ 30 lakhs of machinery acquired on 1.11.2019 and put to use)
Computers:	₹ 15 lakhs

It may be noted that the above values have been duly recognised while providing depreciation in the books of accounts.

(3) During the year 2019-20, the company has employed 24 additional employees (qualified as "workman" under the Industrial Disputes Act, 1947). All these employees contribute to a recognized provident fund. 12 out of 24 employees joined on 1.6.2019 on a salary of ₹ 23,000 per month, 4 joined on 1.7.2019 on a salary of ₹ 26,000 per month, and 8 joined on 1.11.2019 on a salary of ₹ 20,000 per month. The salaries of 2 employees who joined on 1.6.2019 are being settled by bearer cheques every month.

(4) Sales includes 5000 leather bags sold to M/s Sankar (firm), a related party, at a price of ₹ 1,000 each. The selling price to others in the market is at ₹ 1,300 each.

(5) Employees contribution to EPF of ₹ 3 lakhs recovered from their salaries for the month of March 2020 and shown in the Balance Sheet under the head Sundry Creditors was remitted on 31st May, 2020.

Compute the total income and tax payable of Sankar Ltd. for the Assessment Year 2020-21. The turnover of the company for the year ended 31.3.2018 was ₹ 252 crores. Ignore the provisions of MAT.

Answer

Computation of Total Income of Sankar Ltd. for the A.Y. 2020-21

	Particulars	Amount (₹)	
	Net profit as per the statement of profit and loss		2,72,00,000
	Add: Items debited but to be considered separately or to be disallowed		
	(i) Depreciation charged as per Companies Act, 2013	32,00,000	
	(iii) Employer's contribution to EPF	Nil	
	[As per section 43B, employers' contribution to EPF is allowable as deduction, since the same has been deposited on or before the 'due date' of filing of return under section 139(1) i.e., 30.9.2020. Since the same has been debited to statement of profit and loss, no further adjustment is necessary]		
	(iv) Interest on term loan for purchase of plant and machinery [₹ 25 lakhs x 12% x 7/12]	1,75,000	
	[As per the proviso to section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for the period from the date of borrowing till the date on which such asset is first put to use shall not be allowed as deduction. Since the same has been debited to statement of profit and loss, it has to be added back while computing business income]		
	(v) **Payment of labour charges to A & Co., a sub- contractor, without deduction of tax** [30% of ₹10 lakh]	3,00,000	
	[Under section 40(a)(ia), 30% of any sum paid to any resident on which tax is deductible is disallowed if tax is not deducted at source. In this case, TDS provisions under section 194C are attracted on labour charges which are shown separately in the bills. Since tax has not been deducted on labour charges, 30% of the expenditure shall be disallowed]		36,75,000
			3,08,75,000
	Add: Amount taxable but not credited to profit and loss account		
	AI(4) Sale of leather bag at a price lower than the fair market value [₹ 300 x 5,000] [The difference between the sale price (₹ 1,000 per leather bag) and the fair market value (₹ 1,300 per leather bag) multiplied by the quantity sold (5000 leather bags) has to be added since the sale is to a related party at a price lower than the fair market value]	15,00,000	
	AI(5) Employee's contribution to EPF	3,00,000	

	[Any sum received by the assessee from his employees as contribution to any provident fund is treated as income of the assessee. Since employees contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per section 36(1)(va).]		18,00,000
			3,26,75,000
	Less: Items credited to statement of profit and loss, but not includible in business income / permissible expenditure and allowances		
	(**ii**) **Waiver of sundry creditor's outstanding amount**	Nil	
	[Waiver of ₹ 6,00,000 from the sundry creditors is a benefit in respect of a trading-liability by way of remission or cessation thereof and is, hence, taxable under section 41(1). Since the amount is already credited to statement of profit & loss, no adjustment is necessary		
	AI (1)Provision for wages payable to workers		
	[The provision based on fair estimate of wages and reasonable certainty of revision is allowable as deduction, since ICDS X requires 'reasonable certainty' for recognition of a provision, which is present in this case. As the provision has not been debited to statement to profit and loss, the same has to be reduced while computing business income]	12,00,000	12,00,000
			3,14,75,000
	Less: **Depreciation as per Income-tax Rules, 1962**		
	A(2) Depreciation under section 32		
	Depreciation on factory building [10% of ₹180 lakh]	18,00,000	
	Depreciation on plant and machinery		
	- Depreciation@7.5% on ₹ 31.75 lakhs [₹ 30 lakh, being machinery cost + ₹ 1.75 lakh, being interest from 1.4.2019 to 31.10.2019] since machinery is put to use for less than 180 days].	2,38,125	
	- Depreciation@15% on ₹ 140 lakh [₹ 170 lakh –₹30 lakh]	21,00,000	
	- Depreciation on computers [40% of ₹15 lakh]	6,00,000	
		47,38,125	
	Add: Additional depreciation @10% on ₹ 31.75 lakh, since machinery is put to use for less than 180 days	3,17,500	
			50,55,625
	Gross Total Income		**2,64,19,375**
	Less: Deduction under Chapter VI-A		
	Under section 80JJAA **[See Working Note below]**		9,30,000
	Total Income		2,54,89,375
	Total Income (Rounded off)		**2,54,89,380**

Computation of tax payable by Sankar Ltd. for the A.Y. 2020-21

	₹
Tax payable on ₹ 2,54,89,380@25%, since the turnover of the company for the P.Y. 2017-18 does not exceed ₹250 crores	63,72,345

Add: Surcharge@7% (since the total income of the company exceeds ₹ 1 crore but does not exceed ₹10 crore)	4,46,064
	68,18,409
Add: Health and education cess@4%	2,72,736
Tax liability	**70,91,145**
Tax liability (Rounded off)	70,91,150

Working Note:

Computation of deduction under section 80JJAA

Sankar Ltd. is eligible for deduction under section 80JJAA since the company is subject to tax audit under section 44AB for A.Y.2020-21 and has employed "additional employees" during the P.Y.2019-20.	
Number of additional employees	
Total number of employees employed during the year	24
Less: Employees employed on 1.7.2019, since their total monthly emoluments exceed ₹ 25,000	4
Employees employed on 1.6.2019 whose emoluments are paid by bearer cheque	2
Number of additional employees [10 employees employed on 1.6.2019 and 8 employed on 1.11.2019]	**18**
Additional employee cost ₹ 23 lakh, being ₹ 23,000 × 10 ×10 + ₹ 8 lakh, being ₹20,000 x 5 x 8	₹31,00,000
Deduction under section 80JJAA [30% of ₹ 31 lakh]	9,30,000

Question 49

M/s XYZ Private Ltd, located in Mysore is in the business of manufacturing confectionery items which is listed in the Eleventh schedule. The Company had also set up a chocolate manufacturing unit during the year 2017 at Cheruvu village in Ranga Reddy District, a notified backward area in the State of Telangana.

The Statement of Profit and Loss for the year ended 31st March, 2020 showed a net profit of ₹ 500 lakhs after debit/credit of the following items:

Items debited

(1) Depreciation based on useful life of assets ₹ 300 lakhs.

(2) Repairs and maintenance expenses include ₹ 0.20 lakhs spent on an air conditioner installed in the residence of a director.

(3) An amount of ₹ 10 lakhs were spent on salaries and materials purchased for scientific research and development.

(4) An amount of ₹ 10 lakhs was paid to an employee on his voluntary retirement in accordance with a scheme of voluntary retirement.

(5) Purchase of raw materials include purchase of wheat in cash for ₹ 20 lakhs from a Mandi on different dates exceeding ₹ 10,000 per day.

(6) The Company has paid ₹ 5 lakhs as regularization fee to the Municipal Corporation of Mysore to regularize the deviation from the sanctioned plan in construction of the factory building.

Additional Information:

(1) The Company has capitalized glow sign board ₹ 10 lakhs installed in the premises of a dealer.

(2) Closing stock includes 1000 pieces of imported machinery spares at its landed cost as on the

date of import at US $ 20 per piece. Exchange rate on the date of import was 1 US $ = ₹ 68. Exchange rate on 31-3-2020 was 1 US $ = ₹ 70. The market value per piece as on 31-3-2020 was US $ 21.

(3) One of the sundry creditors for supply of rice flour was settled on 28 -3-2020 for ₹ 25 lakhs as against his outstanding balance of ₹ 30 lakhs due to non-supply of the required quality.

However, the entire amount was offset against an amount recoverable from the sister concern of the sundry creditor.

(4) The written down value of assets as on 1-4-2019 was as follows:

1. Factory buildings ₹ 500 lakhs
2. (a) Plant and machinery ₹ 1000 lakhs

   (b) New plant and machinery installed and put to use at Cheruvu, on 1-12-2018 ₹ 300 lakhs and on 1-5-2019 ₹ 600 lakhs.

   (c) Machinery which was sold to M/s ABC Ltd. on 1-4-2013 at its WDV for ₹ 25 lakhs were re-acquired on 1-8-2019 for ₹ 50 lakhs.
3. Lorries and Vans ₹ 100 lakhs.
4. Office Equipment ₹ 50 lakhs.
5. Computers purchased and installed in office on 2-1-2020 ₹ 25 lakhs.

Compute total income of XYZ Private Ltd. for the Assessment Year 2020-21. Ignore MAT.

Answer

Computation of Total Income of M/s XYZ Private Ltd. for the A.Y. 2020-21

Particulars	Amount (₹ in lakhs)	
Profits and gains of business and profession		
Net profit as per Statement of profit and loss		500.00
Add: Items debited but to be considered separately or to be disallowed		
(i) Depreciation as per books of account	300.00	
(ii) Repairs and maintenance expenditure	0.20	
[Expenditure on installation of air-conditioner in the residence of the director is a capital expenditure, the same is not allowable as deduction as per section 37. Since the same has been debited to statement of profit and loss, it has to be added back and depreciation be allowed]		
(iii) Salaries and materials purchased for scientific research and development	-	
[Revenue expenditure for scientific research is allowable as deduction as per section 35(1)(i). Hence, no disallowance is attracted. The expenditure will not qualify for weighted deduction@150% under section 35(2AB), since the company is engaged in manufacture of an article or thing listed in the Eleventh Schedule]		
(iv) VRS compensation paid to an employee	8.00	
[As per section 35DDA, only one-fifth of the VRS compensation of ₹ 10 lakhs paid to an employee is allowable as deduction in the current year. Hence, the balance four-fifth i.e., ₹ 8 lakhs, which is allowable in equal installments in the four successive previous years, has to be added back]		
(v) Purchase of wheat in cash from Mandi	-	

[Cash payment exceeding ₹ 10,000 a day made for purchase of wheat from a Mandi does not attract disallowance under section 40A(3), since the same is covered in the exceptions laid out in Rule 6DD, assuming that the purchases are made directly from the farmers in the Mandi. [Alternatively, if it is assumed that the purchases of wheat in cash are made from wholesalers in the Mandi, disallowance under section 40A(3) would be attracted, and ₹ 20 lakhs has to be added back. Total income, would, accordingly be increased by ₹ 20 lakhs]		
(6) Regularization fee paid to Municipal Corporation of Mysore	5.00	
[Regularization fee paid to Municipal Corporation to regularize the deviation from the sanctioned plan in construction of the factory building is in the nature of penalty as it is paid to compound an offence. Hence it does not qualify for deduction under section 37. As the same has been debited to the statement of profit and loss, it has to be added back]		313.20
		813.20
Add: Amount taxable but not credited to profit and loss account		
AI(3) Amount waived by Sundry Creditors for supply of rice flour		5.00
[Amount waived by sundry creditors for a trading liability i.e., for supply of rice flour is deemed as business income as per section 41(1). Even if the said sum of ₹ 5 lakhs (₹ 30 lakhs – ₹ 25 lakhs) has been offset against amount recoverable from the sister concern of sundry creditor, it has to be added back for computing business income as per section 41(1) being trading liability ceased to exist]		
		818.20
Less: Items credited to profit and loss account, but not includible in business income / permissible expenditure and allowances		
AI(2) Cost of machinery spares included in closing stock		-
[If cost of machinery spares forms part of closing stock, the same must have been included in purchases or opening stock as well. Therefore, since the cost is included in both the debit and credit side of statement of profit and loss, no adjustment is required. The cost of machinery spares has to be added to the machinery cost and depreciation has to be allowed@15% thereunder]		
AI(1) Cost of glow sign board installed in the premises of a dealer		10.00
[Expenditure incurred on glow sign boards does not bring into existence an asset or advantage for the enduring benefit of the business, which is attributable to the capital, the same is revenue in nature. Also, the glow sign board is not an asset of permanent nature. It has a short life. Furthermore, the company has incurred the expenditure with the object of facilitating business operation and not acquiring an asset of enduring nature. Hence, it is allowable as a revenue expenditure and has to be deducted while computing business income]		
AI(4) Investment Allowance under section 32AD		90.00
[15% of ₹ 600 lakhs, being actual cost of new plant and machinery installed on 1.5.2019 in Cheruvu, a notified backward area in Telengana]		

AI(4) Depreciation as per Income-tax Rules, 1962				
(1)	**Factory Buildings**@10% = ₹ 500 lakhs x 10%		50.00	
(2)	**Plant and Machinery [See Notes below]**			
	On Opening WDV = ₹ 1,000 lakhs x 15%	150.00		
	On P&M purchased and put to use on 1.5.2019 [₹ 600 lakhs x 15%]	90.00		
	On imported machinery spares (to be added to cost of machinery as per ICDS V) = ₹13.60 lakhs (1000 x $20 x 68) x 15%, assuming that it has been put to use for more than 180 days during the P.Y.2019-20	2.04		
	On machinery sold and reacquired			
	15% of Actual cost ₹25 lakhs, being lower of WDV at the time of sale (i.e., ₹ 25 lakhs) or price paid for reacquisition (i.e., ₹ 50 lakhs)	3.75		
	Total depreciation on P & M		245.79	
(3)	**Lorries and Vans** = 15% of ₹100 lakhs		15.00	
(4)	**Office Equipment** = 15% of ₹ 50 lakhs		7.50	
(5)	**Computers** (put to use for less than 180 days) = 50% x (40% x ₹ 25 lakhs)		5.00	
(6)	**Air-conditioner** installed at residence of Director@10% of ₹ 0.20 lakhs (assumed to have been put to use for 180 days or more and for business purposes at office residence)		0.02	
			323.31	
Add: Additional depreciation				
On new plant and machinery installed and put to use in notified backward area on 1.12.2018 (50% of 35% would have been allowed in P.Y.2018-19, since it was put to use for less than 180 days in that year. Balance 50% allowable in the P.Y.2019-20) = 50% x 35% x ₹ 300 lakhs			52.50	
On new plant and machinery installed and put to use in notified backward area on 1.5.2019 = 35% x ₹ 600 lakhs			210.00	585.81
Total Income				**132.39**

Notes:

(1) Since additional information (4) mentions the written down value of assets (given thereunder) as on 1.4.2019, it is logical to assume that the figure of ₹ 1000 lakhs, being the WDV of plant and machinery as on 1.4.2019 include the cost of new plant and machinery of ₹ 300 lakhs installed and put to use on 1.12.2018. Accordingly, in the above solution, only balance additional depreciation (i.e., ₹ 52.50) is computed on such new plant and machinery.

Alternatively, if it is assumed that the same is not included in the figure of ₹ 1000 lacs, being the WDV of Plant & Machinery as on 01.04.2019, the total normal depreciation on P&M would be (300 x 15% = 45.00 lac) + 245.79 = 290.79 lacs.

(2) Since the glow sign board has been purchased during the year, the cost of the same is not included in WDV as on 1.4.2019, and hence, it is not being deducted there from.

Question 50

Anamika Builders and Constructions Ltd., a company resident in India is engaged in the business of construction and real estate. Net profit as per profit and loss account is ₹ 54,80,000 (prepared in accordance with ICDS) after debiting/crediting the following items:

(i) Depreciation debited to books ₹ 8,47,000.

(ii) Gross revenue includes ₹ 5,00,000 in respect of a service contract for maintenance of the office building for Nitup Ltd. for the period from 1st March, 2020 to 30th April, 2020. The expenses incurred on the project till 31-3-2020 amounts to ₹ 1,27,000 which is included in other expenses.

(iii) The amount of employee benefits include a sum of ₹ 4,41,000 in respect of bonus payable to employees. In the previous year 2019-20, the company and its employee's union had a dispute over payment of bonus. In order to avoid late payment of bonus, the company formed a trust and transferred the amount of bonus payable to employees to the said trust. The dispute was settled in the month of November, 2020 and the trust paid the amount of bonus to the employees on 30th December, 2020;

(iv) Capital gains on sale of shares in Yara Ltd.₹ 3,77,500.

(v) In respect of one of its on-going projects, the assessee had made some structural changes contrary to what was earlier approved by the municipal authorities. Assessee hence paid a sum of ₹ 98,000 as regularization fee in respect of such changes made in the construction plan.

(vi) Other expenses include ₹ 1,45,000 as expenditure incurred on CSR.

(vii) During the previous year 2019-20, the assessee company decided to expand its business and open a retail petrol out let. Accordingly, a sum of ₹ 1,75,000 was deposited with the concerned authority. However, the assessee could not start this operation and the deposit with the authority was forfeited.

(viii) Amount paid for advertisement in political parties' brochure ₹ 48,000.

(ix) During the previous year 2019-20, the assessee entered into an agreement with Bat Ltd. As per the agreement, Bat Ltd. has agreed to not to engage in the business of real estate trading. The assessee paid ₹ 11 lakhs without deduction of tax at source on 1-6-2019 as non-compete fee.

Additional Information:

(i) Depreciation as per Income-tax Act, 1961 ₹ 5,14,000. This includes an amount of ₹ 78,000 in respect of fire fighting equipments installed in various business premises/ offices of the assessee. During the year, as there were no incidence of fire, these equipments were not used.

(ii) On 26th October, out of 5 unsold office spaces in a mall, the assessee converted one such space into its own office. The fair market value of that space as on that date was ₹ 15,00,000. The cost incurred originally to construct such space was ₹ 10,00,000.

(iii) In respect of ongoing construction contracts, there was a claim for escalation of prices, to the tune of ₹ 8,50,000. The company had filed a lawsuit in the year 2018. In the previous year 2019-20, the court gave its judgement in favour of the company. The company has received ₹ 2,00,000 till 31-03-2020. Gross receipt in the profit and loss account includes ₹ 2,00,000 in respect of such claims.

(iv) The assessee held 250 shares in Yara Ltd. On 1-4-2018, Y Ltd. allotted bonus shares in the ratio of 1 : 1. The company sold all the shares in Yara Ltd. on 24th September 2019 for ₹ 2,050 per share. The company had acquired the original shares for ₹ 540 on 23-06-2016. The fair market value of the shares as at 31st January 2018 was ₹ 1,980 per share.

You are required to compute the total income chargeable to tax in the hands of Anamika Builders and Constructions Ltd., for the Assessment Year 2020-21 giving a brief explanation to each item of additions or deletions. Ignore provisions of MAT.

Answer

Computation of Total Income of M/s Anamika Builders and Construction Ltd. for the A.Y. 2020-21

Particulars	Amount in ₹	
Profits and gains of business and profession		
Net profit as per profit and loss account		54,80,000
Add: Items debited but to be considered separately or to be disallowed		
(i) Depreciation as per books of account	8,47,000	
(iii) Bonus transferred to the trust for making payment to the employees after settlement of the dispute	4,41,000	
[The bonus would be allowable as deduction u/s 36(1)(ii), even though the amount of bonus payable was initially remitted to the trust created for the purpose of avoiding late payment of bonus, provided actual payment of bonus is made to the employees on or before the due date[1]. However, since in the present case, actual payment of bonus to employees is made on 30th December 2020, after due date of filing return of income i.e., after 31st October 2020, deduction u/s 36(1)(ii) would not be allowable merely because the amount was remitted to the trust before the stipulated due date. Since the same has been debited to the profit and loss account, it has to be added back]		
(v) Regularization fee paid to Municipal Authorities	98,000	
[Regularization fee paid to Municipal authorities to regularize the deviation from the earlier approved construction plan in its on-going projects is in the nature of penalty as it is paid to compound an offence. Hence, it does not qualify for deduction u/s 37. As the same has been debited to the profit and loss account, it has to be added back]		
(vi) Expenditure incurred on CSR	1,45,000	
[Under section 37(1), only expenditure not covered under sections 30 to 36, and incurred wholly and exclusively for the purposes of the business is allowed as a deduction while computing taxable business income. Any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall not be allowed as deduction under section 37. As the same has been debited to the profit and loss account, it has to be added back]		
(vii) Expenditure on expansion of new business of retail petrol out let [Where expenditure is incurred on project not related to the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature. Retail petrol outlet is not related to the existing business of construction and real estate, the expenditure incurred on setting up such business would not be allowed as deduction. As the same has been debited to the statement of profit and loss, it has to be added back]	1,75,000	
(v) Amount paid for advertisement in political parties brochure [Section 37(2B)	48,000	
prohibits allowance of any expenditure incurred by an assessee on advertisement in any souvenir, brochure, pamphlet or the like published by a political party. Since the same has been debited to		

the profit and loss account, it has to be added back]		
(viii) Non-compete fees to Bat Ltd.	3,30,000	
[On account of the payment of non-compete fee, the company does not acquire any business, the profit- making apparatus remains the same and there is no new business or new source of income and therefore, the expenditure has to be treated as revenue in nature. Since company has not deducted tax at source u/s 194J on such non-compete fees during the previous year 2019-20, 30% of expenditure i.e., ₹ 3,30,000 would be disallowed]		
Note - The above treatment is based on the Madras High Court ruling in M/s. Asianet Communications Ltd vs CIT, 174/2005 on 26.6.2018		
Alternate treatment is possible based on the Gujarat High Court ruling in PCIT vs Ferromatic Milacron India Pvt, Ltd 1233/2018 on 9.10.2018, as briefed hereunder:		
Rights acquired under a non-compete agreement gives enduring benefit and protects the assessee's business against competition. The expression "or any other business or commercial rights of similar nature" used in Explanation 3 to sub-section 32(1)(ii) is wide enough to include non-compete rights. Hence, such expenditure would be capital expenditure and it would be treated as intangible asset and be eligible for depreciation @25%. In such case, the expenditure which is debited to the profit and loss account, i.e., ₹ 11,00,000, has to be added back and depreciation of ₹ 2,75,000 i.e., 25% would be allowed as deduction. Further, disallowance of 30% of expenditure on account of non-deduction of tax at source would also not be attracted.		
		20,84,000
		75,64,000
Add: Amount taxable but not credited to profit and loss account		
AI(ii) Business income on conversion of stock-in trade into capital asset		15,00,000
[Fair market value of inventory on the date of its conversion or treatment as capital asset, would be chargeable to tax as business income. Since cost of construction of one unsold office space in a mall i.e., ₹ 10,00,000 has already been debited to profit and loss account, the FMV of ₹ 15,00,000 would be chargeable to tax. Hence, such amount has to be included in business income]		
AI(iii)Claim for Escalation price in respect of ongoing construction contracts		6,50,000
[As per section 145B, claim for escalation of a price of ₹ 8,50,000 would be deemed to be income of P.Y. 2019-20 i.e., the previous year in which reasonable certainty of its realization is received, being the year in which the judgment in the favour of the company was given. Since only the sum of ₹ 2,00,000 received by the company till 31.3.2020 is included in the profit and loss account, balance ₹ 6,50,000 has to be included in business income]		
Less: Items credited to profit and loss account, but not includible in business income/permissible expenditure and allowances		**97,14,000**

(ii) Revenue from service contract for maintenance of the office building of Nitup Ltd. [Since the service contract for maintenance of office building is for a period of 61 days i.e., from 1st March 2020 to 30th April 2020 (less than 90 days), the revenue from such contract would be determined on the basis of project completion method. Consequently, the income from contract and the expenditure would also be chargeable/ allowable in the P.Y. 2020-21. Since the revenue of ₹ 5,00,000 is credited and expenditure of ₹ 1,27,000 has been debited to statement of profit and loss, the net amount of ₹ 3,73,000 (₹ 5,00,000 – ₹ 1,27,000) has to be deducted while computing business income of the P.Y. 2019-20]		3,73,000	
(iv) Capital gains on sale of shares in Yara Ltd. [Capital gains on sale of shares in Yara Ltd. is chargeable to tax under the head "Capital Gains". As the same has been credited to the profit and loss account, it has to be reduced]		3,77,500	
AI(i) Depreciation as per Income-tax Rules, 1962 [One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". Courts have held that, in certain circumstances, such as in the case of stand-by equipments, an asset can be said to be in use even when it is "kept ready for use". Since fire-fighting equipments, being stand by equipments, are kept ready for use, the depreciation on these equipments would be allowable, even though they are not actually used. Since the said amount is already included in the figure of depreciation allowable under the Income-tax Act, 1961, no separate adjustment is required]		5,14,000	
Business Income			**84,49,500**
Capital Gain			
In respect of Original Shares			
Sale Consideration [250 shares x ₹2,050]	5,12,500		
Less: Cost of acquisition, being higher of	4,95,000		
- Actual cost [250 x ₹540] 1,35,000 - Lower of 4,95,000 • ₹ 4,95,000 (₹ 1,980 x 250), being fair market value as on 31.1.2018; and • ₹ 5,12,500, being full value of consideration on transfer			
Long-term capital gain under section 112A [Since shares held for more than 12 months, the gain is a LTCG. Benefit of indexation is, however, not available on LTCG taxable u/s 112A].		**17,500**	
In respect of Bonus Shares			
Sale Consideration [250 shares x ₹2,050]	5,12,500		
Less: Cost of acquisition, being higher of	4,95,000		
- Actual cost Nil - Lower of 4,95,000			

• ₹ 4,95,000 (₹ 1,980 x 250),being fair market value as on 31.1.2018; and • ₹ 5,12,500, being full value of consideration on transfer		
Long-term capital gain u/s 112A [Since shares held for more than 12 months, the gain is LTCG. Benefit of indexation is, however, not available on LTCG taxable u/s 112A].	**17,500**	35,000
Gross Total Income		**84,84,500**
Less: **Deduction under Chapter VI-A u/s 80GGB**		
Advertisement in souvenir published by a political party is deemed to be a contribution of such amount to the political party and is, therefore, allowable as deduction in the hands of the company assuming that payment is made otherwise than by way of cash		48,000
Total Income		**84,36,500**

Question 51

Ram Manufactures LLP., engaged in manufacturing activity which is liable for GST@18%. The firm consists of 4 equal partners who contributed ₹ 15 lakhs each as capital. The partnership deed authorises interest on capital@9% per annum besides working partner salary of ₹ 25,000 per month to each partner, as all of them are working partners.

A survey under section 133A was conducted in the premises of the firm on 23-01-2020 and during the course of survey (a) bills and vouchers (each below ₹ 10,000) aggregating to ₹ 2,50,000 were found in the premises which were not recorded in the books of account; and (b) unaccounted stock of ₹ 10,50,000 was found in the premises on 23-01-2020.

Note: No effect was given in the books of account of the firm for the above said items even after the conclusion of survey.

The following issues are presented to you:

(i) Depreciation debited in the profit and loss account includes ₹ 3,00,000 representing depreciation on non-compete fee of ₹ 30,00,000 being the amount paid to a retired partner on 30-4-2017.

(ii) The firm allowed ₹ 4,00,000 as discount on goods sold to A & Co, a proprietary concern owned by one of the partners.

(iii) Depreciation debited to profit and loss account does not include depreciation on the following:

(a) Plant & Machinery (new) acquired in November, 2019 and used during the year cost ₹ 23,60,000 (including GST@18%).

(b) Construction of one factory building was completed on 31st December, 2019 and it was put to use w.e.f. 1-1-2020. The cost of construction admitted in the books was ₹ 40,90,000.

The firm availed loan from a bank for construction of the above said factory building on 20th October, 2018. Interest payable details are as under:

Period	₹
From 20-10-2018 to 31-03-2019	2,00,000
From 01-04-2019 to 31-12-2019	7,00,000

From 01-01-2020 to 31-03-2020	4,20,000

No amount by way of loan interest was paid till 'due date' of filing the return of income prescribed under section 139(1). The loan interest is not debited to profit and loss account and also not included in the cost of construction of the factory building.

(iv) The net profit of the firm for the year ended 31-03-2020 was ₹ 17,21,375 after deducting interest on capital and working partner salary.

You are requested to compute the total income of the firm by giving brief reasons for each of the item given above.

Answer

Computation of total income of Ram Manufacturers LLP for A.Y.2020-21

Particulars	₹	₹
Profits and gains of business or profession		
Net profit of the firm after deducting interest on capital and salary		17,21,375
Add: Items debited but to be considered separately or to be disallowed		
- **Interest on capital**	Nil	
[no adjustment is required since interest@9% p.a. is authorized by the partnership deed and the rate does not exceed 12%]		
- **Salary to working partners** [to be considered separately] [₹25,000 x 12 x 4]	12,00,000	
- **Depreciation on non-compete fee**	3,00,000	
[Since no new asset is created by payment of ₹ 30,00,000 as non-compete fee to a retired partner and the expenditure does not result in enduring benefit in the capital field, it is not capital in nature. Hence, depreciation is not allowable on such expenditure in P.Y. 2019-20]		
Note - The above treatment is based on the Madras High Court ruling in M/s. Asianet Communications Ltd vs CIT, 174/2005 on 26.6.2018.		
- Discount to A & Co., a related party - disallowance u/s 40A(2) is not attracted in this case, since the transaction is a sale transaction with a related party. Also, the question does not mention that the discount given to A & Co. is excessive.	Nil	15,00,000
		32,21,375
Add: Amount taxable but not credited to profit and loss account		
- **Unexplained expenditure**	2,50,000	
[Expenditure not recorded in the books of account to be treated as unexplained expenditure and would be deemed to be the income of Ram Manufactures LLP as per section 69C. It would be taxable @60% plus surcharge @25% plus health and education cess@4%]		
- **Unaccounted stock** detected on survey under section 133A on 23.01.2020 chargeable as income	10,50,000	13,00,000
		45,21,375

Less: Permissible expenditure and allowances		
- **Unexplained expenditure of ₹ 2,50,000** [As per section 69C, unexplained expenditure would not be allowed as deduction under any head of income]	Nil	
- **Depreciation allowable as per Income-tax Rules, 1962**		
(a) Plant & Machinery acquired in November, 2019		
50% of 15% of ₹ 20,00,000 since it is put to use for less than 180 days. [As per Explanation 9 to section 43(1), GST paid on acquisition of P & M would not form part of actual cost where GST input credit has been availed by the firm. Therefore, the actual cost of the P & M would be ₹ 20 lakhs [₹23,60,000 x100/118] **Note** - Alternatively, if it is assumed that input credit on machinery has not been availed under GST law, then, depreciation has to be calculated treating actual cost as ₹ 23,60,000. In such case, permissible normal depreciation will be ₹ 23,60,000 x 15% x 50% i.e., ₹ 1,77,000.	1,50,000	
(b) Factory building@50% of 10% on ₹ 49,90,000 [₹ 40,90,000 being, construction cost + ₹ 9,00,000 being interest from 20.10.2018 to 31.12.2019 i.e., the date of borrowing upto the date of put to use] since it is put to use for less than 180 days	2,49,500	
- **Additional depreciation**@50% of 20% on plant and machinery used, since it was put to use for less than 180 days=10% x ₹20 lakhs **Note** - Alternatively, if it is assumed that input credit on machinery has not been availed under GST law, then, permissible additional depreciation will be ₹ 23,60,000 x 20% x 50% i.e., ₹2,36,000.	2,00,000	5,99,500
- **Interest on loan borrowed for construction of building** [As per section 36(1)(iii), interest for the period after the asset is put to use is allowable as deduction, provided such interest is actually paid on or before due date of filing of return of income as required u/s 43B. Since interest of₹ 4,20,000 for the period after the asset is put to use is not paid till the due date of filing of return of income, it would not be allowed as deduction].		Nil
Book Profit		**39,21,875**
Less: Remuneration to working partners		
Maximum permissible amount u/s 40(b):		
On first ₹3 lakh of book profit at 90% [₹3,00,000 × 90%]	2,70,000	
On balance of book profit at 60% [₹36,21,875 × 60%]	21,73,125	
	24,43,125	
Remuneration actually paid fully allowable as deduction, since it is lower than the specified limit		12,00,000
Total Income		**27,21,875**
Total income (rounded off)		27,21,880

Question 52

SG Securities Private Ltd. is engaged in the business of trading in shares and securities. The details of shares held by it as stock-in-trade as on 31st March, 2020 are given below:

Shares	Cost per share (₹)	Net realisable value per share (₹)
500 shares of P. Ltd	50	65
200 shares of Q. Ltd	35	32
300 shares of R. Ltd	125	110
250 shares of S. Ltd	25	40

The company values its year-end stock-in-trade in accordance with Accounting Standard (AS) 13 - "Accounting for investments of the Companies (Accounting Standards) Rules, 2006".

Determine the amount of adjustments, if any, required to be made in computation of income for Assessment Year 2020-21.

Answer

Shares held as stock-in-trade are accounted and disclosed in the financial statements in the same manner as in respect of current investment.

As per Accounting Standard (AS) 13, current investments are carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment. However, the more prudent and appropriate method is to carry investments individually at the lower of cost and fair value. Net realizable value (NRV) can be taken as fair value, in this case.

Since the company values its year end stock-in-trade in accordance with the AS 13, it would have valued the shares at the lower of cost and fair value on individual investment basis.

Valuation of shares held as stock in trade as per AS 13

Security	Cost (₹)	NRV (₹)	Lower of cost or NRV
500 shares of P. Ltd.	25,000 (500 x 50)	32,500 (500 x 65)	₹ 25,000
200 shares of Q. Ltd.	7,000 (200 x 35)	6,400 (200 x 32)	₹ 6,400
300 shares of R. Ltd.	37,500 (300 x 125)	33,000 (300 x 110)	₹ 33,000
250 shares of S. Ltd.	6,250 (250 x 25)	10,000 (250 x 40)	₹ 6,250
Value of stock-in-trade as per AS 13			**₹ 70,650**

ICDS-VIII on securities requires securities held as stock-in-trade to be valued at actual cost initially recognised or net realisable value (NRV) at the end of that previous year, whichever is lower. It also requires the comparison of actual cost initially recognised and net realisable value to be done category wise and not for each individual security.

Valuation of shares held as stock in trade as per ICDS VIII

Security	Cost (₹)	NRV (₹)	Lower of cost or NRV
500 shares of P. Ltd.	25,000 (500 x 50)	32,500 (500 x 65)	
200 shares of Q. Ltd.	7,000 (200 x 35)	6,400 (200 x 32)	
300 shares of R. Ltd.	37,500 (300 x 125)	33,000 (300 x 110)	
250 shares of S. Ltd.	6,250 (250 x 25)	10,000 (250 x 40)	
Value of stock-in-trade as per ICDS	75,750	81,900	**₹ 75,750**

SG Securities Pvt. Ltd. is required to value its shares held as stock in trade at ₹ 75,750 as per ICDS VIII for income-tax purpose. Accordingly, its income would be increased by ₹5,100 (₹75,750 – ₹ 70,650).

Note – AS 13 also permits valuation of shares on category of investment basis, in which case, there would be no increase in total income under the Income-tax Act, 1961.

CHAPTER - 7
Capital Gains

Section A – ICAI Study Material Questions

Question 1

X converts his capital asset (acquired on June 10, 2003 for ₹ 60,000) into stock-in-trade on March 10, 2019. The fair market value on the date of the above conversion was ₹ 5,50,000. He subsequently sells the stock-in-trade so converted for ₹6,00,000 on June 10, 2019. Examine the tax implication.

Cost Inflation Index - F.Y. 2003-04: 109; F.Y. 2018-19: 280; F.Y. 2019-20: 289.

Answer

Since the capital asset is converted into stock-in-trade during the previous year relevant to the A.Y. 2019-20, it will be a transfer under section 2(47) during the P.Y.2018-19. However, the profits or gains arising from the above conversion will be chargeable to tax during the A.Y. 2020-21, since the stock-in-trade has been sold only on June 10, 2019. For this purpose, the fair market value on the date of such conversion (i.e. 10th March, 2019) will be the full value of consideration.

The capital gains will be computed after deducting the indexed cost of acquisition from the full value of consideration. The cost inflation index for 2003-04 i.e., the year of acquisition is 109 and the index for the year of transfer i.e., 2018-19 is 280. The indexed cost of acquisition is 60,000 × 280/109 = ₹ 1,54,128. Hence, ₹ 3,95,872 (i.e. ₹ 5,50,000 – ₹ 1,54,128) will be treated as long- term capital gains chargeable to tax during the A.Y.2020-21. During the same assessment year, ₹ 50,000 (₹ 6,00,000 - ₹ 5,50,000) will be chargeable to tax as business profits.

Question 2

M held 2000 shares in a company ABC Ltd. This company amalgamated with another company during the previous year ending 31-3-2020. Under the scheme of amalgamation, M was allotted 1000 shares in the new company. The market value of shares allotted is higher by ₹ 50,000 than the value of holding in ABC Ltd.

The Assessing Officer proposes to treat the transaction as an exchange and to tax ₹ 50,000 as capital gain. Is he justified?

Answer

In the above question, assuming that the amalgamated company is an Indian company, the transaction is squarely covered by the exemption explained above and the proposal of the Assessing Officer to treat the transaction as an exchange is not justified.

Question 3

In which of the following situations capital gains tax liability does not arise?

(i) Mr. A purchased gold in 1970 for ₹ 25,000. In the P.Y. 2019-20, he gifted it to his son at the time of marriage. Fair market value (FMV) of the gold on the day the gift was made was ₹ 1,00,000.

(ii) A house property is purchased by a Hindu undivided family in 1945 for ₹ 20,000. It is given to one of the family members in the P.Y. 2019-20 at the time of partition of the family. FMV on the day of partition was ₹ 12,00,000.

(iii) Mr. B purchased 50 convertible debentures for ₹ 40,000 in 1995 which are converted in to 500 shares worth ₹ 85,000 in November 2019 by the company.

Answer

We know that capital gains arise only when we transfer a capital asset. The liability of capital gains tax in the situations given above is discussed as follows:

(i) As per the provisions of section 47(iii), transfer of a capital asset under a gift is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

(ii) As per the provisions of section 47(i), transfer of a capital asset (being in kind) on the total or partial partition of Hindu undivided family is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

(iii) As per the provisions of section 47(x), transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form of a company into shares or debentures of that company is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

Question 4

Mr. Abhishek a senior citizen, mortgaged his residential house with a bank, under a notified reverse mortgage scheme. He was getting loan from bank in monthly installments. Mr. Abhishek did not repay the loan on maturity and hence gave possession of the house to the bank, to discharge his loan. How will the treatment of long-term capital gain be on such reverse mortgage transaction?

Answer

Section 47(xvi) provides that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government shall not be considered as a transfer for the purpose of capital gain.

Accordingly, the mortgaging of residential house with bank by Mr. Abhishek will not be regarded as a transfer. Therefore, no capital gain will be charged on such transaction.

Further, section 10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in installment, in a transaction of reverse mortgage would be exempt from income-tax. Therefore, the monthly installment amounts received by Mr. Abhishek would not be taxable.

However, capital gains tax liability would be attracted at the stage of alienation of the mortgaged property by the bank for the purposes of recovering the loan.

Question 5

On 21.07.2019 the business of Neerja Textiles was succeeded by New Look Textile Private Limited and all the assets and liabilities of Neerja Textiles on that date became the assets and liabilities of New Look Textile Private Limited and Neerja was given 52% share in the share capital of the company. No other consideration was given to Neerja on account of this succession.

The assets and liabilities of Neerja Textiles transferred to the company include an urban land which was acquired by Neerja on 19.7.2013 for ₹ 9,80,000. The company sold the same on 30.03.2020 for ₹ 15,00,000.
Examine the tax implication of the above-mentioned transaction and compute the income chargeable to tax in such case(s).
Cost Inflation Index: F.Y. 2013-14: 220; F.Y. 2019-20: 289

Answer

Taxability in case of succession of Neerja Textiles by New Look Textile Private Limited

As per provisions of section 47(xiv), in case a proprietorship concern is succeeded by a company in the business carried by it and as a result of which any capital asset is transferred to the company, then the same shall not be treated as transfer and will not be chargeable to capital gain tax in case the following conditions are satisfied:

(1) all the assets and liabilities of sole proprietary concern becomes the assets and liabilities of the company.

(2) the shareholding of the sole proprietor in the company is not less than 50% of the total voting power of the company and continues to remain as such for a period of 5 years from the date of succession.

(3) the sole proprietor does not receive any consideration or benefit in any form from the company other than by way of allotment of shares in the company.

In the present case, all the conditions mentioned above are satisfied therefore, the transfer of capital asset by Neerja Textiles to New Look Textiles Private Limited shall not attract capital gain tax provided Neerja continues to hold 50% or more of voting power of New Look Textiles Private Limited for a minimum period of 5 years.

Taxability in case of transfer of land by New Look Textiles Private Limited

As per the provisions of section 49(1) and Explanation 1 to section 2(42A), in case a capital asset is transferred in the circumstances mentioned in section 47(xiv), the cost of the asset in the hands of the company shall be the cost of the asset in the hands of the sole proprietor. Consequently, for the determining the period of holding of the asset, the period for which the asset is held by the sole proprietor shall also be considered.

Therefore, in the present case, the urban land shall be a long-term capital asset since it is held for more than 24 months by New Look Textile Private Limited and Neerja Textiles taken together. Cost of acquisition of land in the hands of the company shall be ₹ 9,80,000 i.e., the purchase cost of the land in the hands of Neerja.

Computation of capital gain chargeable to tax in the hands of New Look Textile Private Ltd.

Particulars	₹
Net Sale Consideration	15,00,000
Less: Indexed cost of acquisition 9,80,000 × 289/289 (Refer Note below)	9,80,000
Long-term capital gain	5,20,000

Note: The year of transfer and the year in which the company first held the asset are the same in this case, which is the reason why the numerator and the denominator for calculating the indexed cost of acquisition would remain the same. Therefore, in effect, there is no benefit of indexation in this case. However, as per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by taking the CII of F.Y.2013-14 i.e., 220, being the year in which the capital asset was acquired by the previous owner, Neerja, as the denominator, in which case, the capital gains chargeable to tax would undergo a change. The long-term capital gains in such a case would be ₹ 2,12,636 [₹ 15,00,000 - ₹ 12,87,364 (9,80,000 x ₹ 289/220)].

Question 6

ABC Ltd. converts its capital asset acquired for an amount of ₹ 50,000 in June, 2003 into stock-in-trade in the month of November, 2017. The fair market value of the asset on the date of conversion is ₹ 4,50,000. The stock-in-trade was sold for an amount of ₹ 6,50,000 in the month of September, 2019. What will be the tax treatment?

Financial year	Cost Inflation Index
2003-04	109
2017-18	272
2019-20	289

Answer

The capital gains on the sale of the capital asset converted to stock-in-trade is taxable in the given case. It arises in the year of conversion (i.e. P.Y. 2017-18) but will be taxable only in the year in which the stock-in-trade is sold (i.e. P.Y. 2019-20). Profits from business will also be taxable in the year of sale of the stock-in-trade (P.Y. 2019-20).
The long-term capital gains and business income for the A.Y.2020-21 are calculated as under:

Particulars	₹	₹
Profits and Gains from Business or Profession		
Sale proceeds of the stock-in-trade	6,50,000	
Less: Cost of the stock-in-trade (FMV on the date of conversion)	4,50,000	2,00,000
Long Term Capital Gains		
Full value of the consideration (FMV on the date of the conversion)	4,50,000	
Less: Indexed cost of acquisition (₹ 50,000 x 272/109)	1,24,771	3,25,229

Note: For the purpose of indexation, the cost inflation index of the year in which the asset is converted into stock-in-trade should be considered.

Question 7

Ms. Usha purchases 1,000 equity shares in X Ltd., an unlisted company, at a cost of ₹ 30 per share (brokerage 1%) in January 1996. She gets 100 bonus shares in August 2000. She again gets 1,100 bonus shares by virtue of her holding on February 2006. Fair market value of the shares of X Ltd. on April 1, 2001 is ₹ 80.
On 1st January 2020, she transfers all her shares @ ₹ 200 per share (brokerage 2%). Compute the capital gains taxable in the hands of Ms. Usha for the A.Y. 2020-21
Cost Inflation Index for F.Y. 2001-02: 100, F.Y.2005-06: 117 & F.Y.2019-20: 289.

Answer

Computation of capital gains for the A.Y. 2020-21

Particulars	₹
1000 Original shares	
Sale proceeds (1000 × ₹ 200)	2,00,000
Less : Brokerage paid (2% of ₹ 2,00,000)	4,000
Net sale consideration	1,96,000
Less : Indexed cost of acquisition [₹ 80 × 1000 × 289/100]	2,31,200
Long term capital loss (A)	**(35,200)**
100 Bonus shares	
Sale proceeds (100 × ₹ 200)	20,000

Less : Brokerage paid (2% of ₹ 20,000)	400
Net sale consideration	19,600
Less : Indexed cost of acquisition [₹ 80 × 100 ×289/100] [See Note below]	23,120
Long term capital loss (B)	**(3,520)**
1100 Bonus shares	
Sale proceeds (1100 × ₹ 200)	2,20,000
Less: Brokerage paid (2% of ₹2,20,000)	4,400
Net sale consideration	2,15,600
Less: Cost of acquisition	NIL
Long term capital gain (C)	2,15,600
Long term capital gain (A+B+C)	**1,76,880**

Note: Cost of acquisition of bonus shares acquired before 1.4.2001 is the FMV as on 1.4.2001 (being the higher of the cost or the FMV as on 1.4.2001).

Question 8

On January 31, 2020, Mr. A has transferred self-generated goodwill of his profession for a sale consideration of ₹ 70,000 and incurred expenses of ₹ 5,000 for such transfer. You are required to compute the capital gains chargeable to tax in the hands of Mr. A for the A.Y. 2020-21.

Answer

The transfer of self-generated goodwill of profession is not chargeable to tax. It is based upon the Supreme Court's ruling in CIT vs. B.C. Srinivasa Shetty.

Question 9

Mr. R holds 1,000 shares in Star Minus Ltd., an unlisted company, acquired in the year 2001-02 at a cost of ₹ 75,000. He has been offered right shares by the company in the month of August, 2019 at ₹ 160 per share, in the ratio of 2 for every 5 held. He retains 50% of the rights and renounces the balance right shares in favour of Mr. Q for ₹ 30 per share in September 2019. All the shares are sold by Mr. R for ₹ 300 per share in January 2020 and Mr. Q sells his shares in December 2019 at ₹ 280 per share. What are the capital gains taxable in the hands of Mr. R and Mr. Q?

Financial year	Cost Inflation Index
2001-02	100
2019-20	289

Answer

Computation of capital gains in the hands of Mr. R for the A.Y.2020-21

Particulars	₹
1000 Original shares	
Sale proceeds (1000 × ₹300)	3,00,000
Less : Indexed cost of acquisition [₹75,000 × 289/100]	2,16,750
Long-term capital gain (A)	83,250
200 Right shares	
Sale proceeds (200 × ₹300)	60,000

Less : Cost of acquisition [₹160 × 200] **[Note 1]**		32,000
	Short-term capital gain (B)	28,000
Sale of Right Entitlement		
Sale proceeds (200 × ₹30)		6,000
Less : Cost of acquisition **[Note 2]**		NIL
	Short-term capital gain (C)	6,000
	Capital Gains (A+B+C)	**1,17,250**

Note 1: Since the holding period of these shares is less than 24 months, they are short term capital assets and hence cost of acquisition will not be indexed.

Note 2: The cost of the rights renounced in favour of another person for a consideration is taken to be nil. The consideration so received is taxed as short-term capital gains in full. The period of holding is taken from the date of the rights offer to the date of the renouncement.

Computation of capital gains in the hands of Mr. Q for the A.Y.2020-21

Particulars	₹
Sale proceeds (200 shares × ₹ 280)	56,000
Less: Cost of acquisition [200 shares × (₹ 30 + ₹ 160)] **[See Note below]**	38,000
Short-term capital gain	**18,000**

Note: The cost of the rights is the amount paid to Mr. R as well as the amount paid to the company. Since the holding period of these shares is less than 24 months, they are short term capital assets.

Question 10

X & sons, HUF, purchased a land for ₹ 1,20,000 in the P.Y. 2002-03. In the P.Y. 2006-07, a partition takes place when Mr. A, a coparcener, is allotted this plot valued at ₹ 1,50,000. In P.Y. 2007-08, he had incurred expenses of ₹ 2,35,000 towards fencing of the plot. Mr. A sells this plot of land for ₹ 15,00,000 in P.Y. 2019-20 after incurring expenses to the extent of ₹ 20,000. You are required to compute the capital gain for the A.Y.2020-21.

Financial year	Cost Inflation Index
2002-03	105
2006-07	122
2007-08	129
2019-20	289

Answer

Computation of taxable capital gains for the A.Y.2020-21

Particulars	₹	₹
Sale consideration		15,00,000
Less: Expenses incurred for transfer		20,000
		14,80,000
Less: (i) Indexed cost of acquisition (₹ 1,20,000 ⍰289/122)	2,84,262	
(ii) Indexed cost of improvement (₹ 2,35,000 ⍰289/129)	5,26,473	8,10,735

Long term capital gains		**6,69,265**

Note - As per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by considering the Cost Inflation Index of F.Y.2002-03.

Question 11

Mr. C purchases a house property for ₹ 1,06,000 on May 15, 1975. The following expenses are incurred by him for making addition/alternation to the house property:

	Particulars	₹
a.	Cost of construction of first floor in 1982-83	3,10,000
b.	Cost of construction of the second floor in 2002-03	7,35,000
c.	Reconstruction of the property in 2012-13	5,50,000

Fair market value of the property on April 1, 2001 is ₹ 8,50,000. The house property is sold by Mr. C on August 10, 2019 for ₹ 68,00,000 (expenses incurred on transfer: ₹ 50,000). Compute the capital gain for the assessment year 2020-21.

Cost Inflation Index: F.Y. 2001-02: 100, F.Y. 2002-03: 105, F.Y. 2012-13: 200, F.Y. 2019-20: 289

Answer

Computation of capital gain of Mr. C for the A.Y.2020-21

Particulars	₹	₹
Gross sale consideration		68,00,000
Less: Expenses on transfer		50,000
Net sale consideration		67,50,000
Less: Indexed cost of acquisition (Note 1)	24,56,500	
Less: Indexed cost of improvement (Note 2)	28,17,750	52,74,250
Long-term capital gain		**14,75,750**

Notes:

Indexed cost of acquisition: ₹ 8,50,000 × 289/100 = ₹ 24,56,500

Fair market value on April 1, 2001 (actual cost of acquisition is ignored as it is lower than market value on April 1, 2001.)

Indexed cost of improvement is determined as under:

Particulars	₹
Construction of first floor in 1982-83 (expenses incurred prior to April 1, 2001 are not considered)	Nil
Construction of second floor in 2002-03 (i.e., ₹ 7,35,000 ×289/105)	20,23,000
Alternation/reconstruction in 2012-13 (i.e., ₹ 5,50,000 ×289/200)	7,94,750
Indexed cost of improvement	**28,17,750**

Question 12

Singhania & Co., a sole proprietorship own six machines, put in use for business in March, 2019. The depreciation on these machines is charged @15%. The written down value of these machines as on 1st April, 2019 was ₹ 8,50,000. Three of the old machines were sold on 10th June, 2019 for ₹ 11,00,000. A second hand plant was bought for ₹ 8,50,000 on 30th November, 2019. You are required to:

(i) determine the claim of depreciation for Assessment Year 2020-21.

(ii) compute the capital gains liable to tax for Assessment Year 2020-21.

(iii) If Singhania & Co. had sold the three machines in June, 2019 for ₹ 21,00,000, will there be any difference in your above workings? Examine.

Answer

(i) Computation of depreciation for A.Y.2020-21

Particulars	₹
W.D.V. of the block as on 1.4.2019	8,50,000
Add: Purchase of second hand plant during the year	8,50,000
	17,00,000
Less: Sale consideration of old machinery during the year	11,00,000
W.D.V of the block as on 31.03.2020	**6,00,000**

Since the value of the block as on 31.3.2020 comprises of a new asset which has been put to use for less than 180 days, depreciation is restricted to 50% of the prescribed percentage of 15% i.e. depreciation is restricted to 7½%. Therefore, the depreciation allowable for the year is ₹ 45,000, being 7½% of ₹ 6,00,000.

(ii) The provisions under section 50 for computation of capital gains in the case of depreciable assets can be invoked only under the following circumstances:

(a) When one or some of the assets in the block are sold for consideration more than the value of the block.

(b) When all the assets are transferred for a consideration more than the value of the block.

(c) When all the assets are transferred for a consideration less than the value of the block.

Since in the first two cases, the sale consideration is more than the written down value of the block, the computation would result in short term capital gains.

In the third case, since the written down value exceeds the sale consideration, the resultant figure would be a short-term capital loss.

In the given case, capital gains will not arise as the block of asset continues to exist, and some of the assets are sold for a price which is lesser than the written down value of the block.

(iii) If the three machines are sold in June, 2019 for ₹ 21,00,000, then short term capital gains would arise, since the sale consideration is more than the aggregate of the written down value of the block at the beginning of the year and the additions made during the year.

Particulars	₹	₹
Sale consideration		21,00,000
Less: W.D.V. of the machines as on 1.4.2019	8,50,000	
Purchase of second hand plant during the year	8,50,000	17,00,000
Short term capital gains		**4,00,000**

Question 13

Mr. A is a proprietor of Akash Enterprises having 2 units. He transferred on 1.4.2019 his Unit 1 by way of slump sale for a total consideration of ₹ 25 lacs. Unit 1 was started in the year 2005-06. The expenses incurred for this transfer were ₹ 28,000. His Balance Sheet as on 31.3.2019 is as under:

Liabilities	Total (₹)	Assets	Unit 1(₹)	Unit 2 (₹)	Total (₹)
Own Capital	15,00,000	Building	12,00,000	2,00,000	14,00,000
Revaluation Reserve	3,00,000	Machinery	3,00,000	1,00,000	4,00,000
Bank loan (70% for unit 1)	2,00,000	Debtors	1,00,000	40,000	1,40,000
Trade creditors (25% for unit 1)	1,50,000	Other assets	1,50,000	60,000	2,10,000
Total	**21,50,000**	**Total**	**17,50,000**	**4,00,000**	**21,50,000**

Other information:

(i) Revaluation reserve is created by revising upward the value of the building of Unit 1.

(ii) No individual value of any asset is considered in the transfer deed.

(iii) Other assets of Unit 1 include patents acquired on 1.7.2017 for ₹ 50,000 on which no depreciation has been charged.

Compute the capital gain for the assessment year 2020-21.

Answer

Computation of capital gains on slump sale of Unit 1

Particulars	₹
Sale value	25,00,000
Less: Expenses on sale	28,000
Net sale consideration	24,72,000
Less: Net worth **(See Note 1 below)**	12,50,625
Long-term capital gain	**12,21,375**

Notes:

1. Computation of net worth of Unit 1 of Akash Enterprises

Particulars	₹	₹
Building (excluding ₹ 3 lakhs on account of revaluation)		9,00,000
Machinery		3,00,000
Debtors		1,00,000
Patents **(See Note 2 below)**		28,125
Other assets (₹ 1,50,000 – ₹ 50,000)		1,00,000
Total assets		14,28,125
Less: Creditors	37,500	
Bank Loan	1,40,000	1,77,500
Net worth		**12,50,625**

2. Written down value of patents as on 1.4.2019

Value of patents	₹
Cost as on 1.7.2017	50,000
Less: Depreciation @ 25% for Financial Year 2017-18	12,500
WDV as on 1.4.2018	37,500
Less: Depreciation for Financial Year 2018-19	9,375
WDV as on 1.4.2019	**28,125**

For the purposes of computation of net worth, the written down value determined as per section 43(6) has to be considered in the case of depreciable assets. The problem has been solved assuming that the Balance Sheet values of ₹ 3 lakh and ₹ 9 lakh (₹ 12 lakh – ₹ 3 lakh) represent the written down value of machinery and building, respectively, of Unit 1.

3. Since the Unit is held for more than 36 months, capital gain arising would be long term capital gain. However, indexation benefit is not available in case of slump sale.

Question 14

Mr. Kay purchases a house property on April 10, 1992 for ₹ 65,000. The fair market value of the house property on April 1, 2001 was ₹ 2,70,000. On August 31, 2004, Mr. Kay enters into an agreement with Mr. Jay for sale of such property for ₹ 3,70,000 and received an amount of ₹ 60,000 as advance. However, as Mr. Jay did not pay the balance amount, Mr. Kay forfeited the advance. In May 2008, Mr. Kay constructed the first floor by incurring a cost of ₹ 2,35,000. Subsequently, in January 2009, Mr. Kay gifted the house to his friend Mr. Dee. On February 10, 2020, Mr. Dee sold the house for ₹ 12,00,000.

CII for F.Y.2001-02: 100; 2004-05: 113; 2008-09: 137; 2019-20: 289.

Compute the capital gains in the hands of Mr. Dee for A.Y.2020-21.

Answer

Computation of taxable capital gains of Mr. Dee for A.Y.2020-21

Particulars	₹	₹
Sale consideration		12,00,000
Less: Indexed cost of acquisition (See Note below)	5,69,562	
Indexed cost of improvement (See Note below)	4,95,730	10,65,292
Long-term capital gain		**1,34,708**

Note: For the purpose of capital gains, holding period is considered from the date on which the house was purchased by Mr. Kay, till the date of sale. However, indexation of cost of acquisition is considered from the date on which the house was gifted by Mr. Kay to Mr. Dee, till the date of sale. i.e. from January 2009 (P.Y. 2008-09) to February, 2020 (P.Y. 2019-20).

Indexed cost of acquisition = (₹ 2,70,000 × 289/137) = ₹ 5,69,562 Indexed cost of improvement = (₹ 2,35,000 × 289/137) = ₹ 4,95,730

Amount forfeited by previous owner, Mr. Kay, shall not be deducted from cost of acquisition.

Alternative view - As per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is

considered, the indexed cost of acquisition would have to be calculated by taking the CII of F.Y.2001-02, since the Fair Market Value as on 1.4.2001 has been taken as the cost of acquisition.

Note – In case, Mr. Kay had gifted the house to his friend Mr. Dee on or after 1.10.2009, the stamp duty value of the property which was subject to tax in the hands of Mr. Dee under section 56(2) would be deemed to be the cost of acquisition for computation of capital gains.

Question 15

Mr. X purchases a house property in December 1993 for ₹ 5,25,000 and an amount of ₹ 1,75,000 was spent on the improvement and repairs of the property in March, 1997. The property was proposed to be sold to Mr. Z in the month of May, 2007 and an advance of ₹ 40,000 was taken from him. As the entire money was not paid in time, Mr. X forfeited the advance and subsequently sold the property to Mr. Y in the month of March, 2020 for ₹ 52,00,000. The fair value of the property on April 1, 2001 was ₹ 11,90,000. What is the capital gain chargeable in the hands of Mr. X for the A.Y. 2020-21?

Financial year	Cost Inflation Index
2001-02	100
2007-08	129
2019-20	289

Answer

Capital gains in the hands of Mr. X for the A.Y.2020-21 is computed as under

Particulars	₹
Sale proceeds	52,00,000
Less : Indexed cost of acquisition **[Note 1]**	33,23,500
Indexed cost of improvement **[Note 2]**	-
Long term capital gains	**18,76,500**

Note 1: Computation of indexed cost of acquisition

Cost of acquisition (higher of fair market value as on April 1, 2001 and the actual cost of acquisition)	11,90,000
Less : Advance taken and forfeited	40,000
Cost for the purposes of indexation	11,50,000
Indexed cost of acquisition (₹11,50,000 x 289/100)	33,23,500

Note 2: Any improvement cost incurred prior to 1.4.2001 is to be ignored when fair market value as on 1.4.2001 is taken into consideration.

Question 16

Mr. Kumar has an agricultural land costing ₹ 6 lakh in Lucknow on 1.4.2003 and has been using it for agricultural purposes till 1.8.2012 when the Government took over compulsory acquisition of this land. A compensation of ₹ 12 lakh was settled. The compensation was received by Mr. Kumar on 1.7.2019. Compute the amount of capital gains taxable in the hands of Mr. Kumar.

Cost Inflation Index: 2003-04: 109, 2012-13: 200, 2019-20: 289

Will your answer be any different if Mr. Kumar had by his own will sold this land to his friend Mr. Sharma? Examine.

Will your answer be different if Mr. Kumar had not used this land for agricultural activities? Examine and compute the amount of capital gains taxable in the hands of Mr. Kumar, if any.

Will your answer be different if the land belonged to ABC Ltd. and not Mr. Kumar and compensation on compulsory acquisition was received by the company? Examine.

Answer

In the given problem, compulsory acquisition of an urban agricultural land has taken place and the compensation is received after 1.4.2004. This land had also been used for at least 2 years by the assessee himself for agricultural purposes. Thus, as per section 10(37), entire capital gains arising on such compulsory acquisition will be fully exempt and nothing is taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e. A.Y.2020-21.

As per section 10(37), exemption is available if compulsory acquisition of urban agricultural land takes place. Since the sale is out of own will and desire, the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Kumar.

As per section 10(37), exemption is available only when such land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such HUF. Since the assessee has not used it for agricultural activities, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e., A.Y. 2020-21.

Computation of capital gains

Particulars	Amount (₹)
Sales consideration	12,00,000
Less: Cost of acquisition (₹ 6,00,000 x 200/109)	11,00,917
Long term capital Gains	99,083

Section 10(37) exempts capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition. If the land belongs to ABC Ltd., a company, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of ABC Ltd.

Question 17

PQR Ltd., purchased a land for industrial undertaking in May 2004, at a cost of ₹ 3,50,000. The above property was compulsorily acquired by the State Government at a compensation of ₹ 12,00,000 in the month of January, 2020. The compensation was received in February, 2020. The company purchased another land for its industrial undertaking at a cost of ₹ 2,00,000 in the month of March, 2020. What is the amount of the capital gains chargeable to tax in the hands of the company for the A.Y. 2020-21?

Financial year	Cost Inflation Index
2004-05	113
2019-20	289

Answer

Computation of capital gains in the hands of PQR Ltd. for the A.Y.2020-21

Particulars	₹
Sale proceeds (Compensation received)	12,00,000
Less : Indexed cost of acquisition [₹ 3,50,000 × 289/113]	8,95,132
	3,04,867
Less: Exemption under section 54D (Cost of acquisition of land for its undertaking)	2,00,000
Taxable long term capital gain	**1,04,867**

Question 18

From the following particulars, compute the taxable capital gains of Mr. D for A.Y.2020-21 -

Particulars	Amount (₹)
Cost of jewellery [Purchased in F.Y.2005-06]	4,52,000
Sale price of jewellery sold in January 2020	11,50,000
Expenses on transfer	7,000
Residential house purchased in March 2020	5,00,000

The cost inflation Index are as follows:

Financial Year	Cost Inflation Index
2005-06	117
2019-20	289

Answer

Computation of taxable capital gains for A.Y.2020-21

Particulars	₹
Gross consideration	11,50,000
Less: Expenses on transfer	7,000
Net consideration	11,43,000
Less: Indexed cost of acquisition (₹ 4,52,000 × 289/117)	11,16,479
	26,521
Less: Exemption under section 54F (₹ 26,521 × ₹ 5,00,000/ ₹ 11,43,000)	11,601
Taxable capital gains	**14,920**

Question 19

Mr. Akash sold his residential property on 2nd February, 2020 for ₹ 90 lakh and paid brokerage@1% of sale price. He had purchased the said property in May 2002 for ₹ 24,36,000. In June, 2020, he invested ₹ 75 lakh in equity of A(P) Ltd., an eligible start-up company, which constituted 27% of share capital of the said company. A(P) Ltd. utilized the said sum for the following purposes –

(a) Purchase of new plant and machinery during July 2020 – ₹ 65 lakh

(b) Included in (a) above is ₹ 8 lakh for purchase of cars.

(c) Air-conditioners purchased for ₹ 1 lakh, included in the (a) above, were installed at the residence of Mr. Akash.

(d) Amount deposited in specified bank on 28.9.2020 – ₹ 10 lakh

Compute the chargeable capital gain for the A.Y.2020-21. Assume that Mr. Akash is liable to file his return of income on or before 30th September, 2020 and he files his return on 29.09.2020.

Cost Inflation Index: 2002-03: 105, 2019-20: 289

Answer

Computation of taxable capital gains for A.Y.2020-21

Particulars	₹
Gross consideration	90,00,000
Less: Expenses on transfer (1% of the gross consideration)	90,000
Net consideration	89,10,000
Less: Indexed cost of acquisition (₹ 24,36,000 × 289/105)	67,04,800
	22,05,200
Less: Exemption under section 54GB (₹ 22,05,200 × ₹ 66,00,000 /₹ 89,10,000)	16,33,481
Taxable capital gains	**5,71,719**

Deemed cost of new plant and machinery for exemption under section 54GB

Particulars	₹	₹
(1) Purchase cost of new plant and machinery acquired in July, 2020		65,00,000
Less: Cost of vehicles, i.e., cars	8,00,000	
Cost of air-conditioners installed at the residence of Mr. Akash	1,00,000	9,00,000
		56,00,000
(2) Amount deposited in the specified bank before the due date of filing of return		10,00,000
Deemed cost of new plant and machinery for exemption under section 54GB		**66,00,000**

Question 20

Calculate the income-tax liability for the assessment year 2020-21 in the following cases:

	Mr. A (age 45)	Mrs. B (age 62)	Mr. C (age 81)	Mr. D (age 82)
Status	Resident	Non- resident	Resident	Non- resident
Total income other than long-term capital gain	2,40,000	2,80,000	5,90,000	4,80,000

Long-term capital gain	15,000 from sale of vacant site	10,000 from sale of listed equity shares (STT paid on sale and purchase of shares)	60,000 from sale of agricultural land in rural area	Nil

Answer

Computation of income-tax liability for the A.Y. 2020-21

Particulars	**Mr. A (age 45)**	**Mrs. B (age 62)**	**Mr. C (age 81)**	**Mr. D (age 82)**
Residential Status	Resident	Non-resident	Resident	Non-resident
Applicable basic exemption limit	₹ 2,50,000	₹ 2,50,000	₹ 5,00,000	₹ 2,50,000
Asset sold	Vacant site	Listed equity shares (STT paid on both sale and purchase of shares)	Rural agricultural land	-
Long-term capital gain (on sale of above asset)	₹ 15,000 [Taxable@20% u/s 112]	₹ 10,000 [Exempt u/s 112A since it is less than ₹ 1,00,000]	₹ 60,000 (Exempt – not a capital asset)	-
Other income	₹ 2,40,000	₹ 2,80,000	₹ 5,90,000	₹ 4,80,000
Tax liability				
On LTCG (after adjusting unexhausted basice limit of ₹ 10,000) i.e., 20% x ₹ 5,000	₹ 1,000	-	-	-
On Other income	Nil	₹ 1,500	₹ 18,000	₹ 11,500
	₹ 1,000	₹ 1,500	₹ 18,000	₹ 11,500
Less: Rebate u/s 87A	₹ 1,000	-	-	-
	Nil	₹ 1,500	₹ 18,000	₹ 11,500
Add: Health and education cess @4%	Nil	₹ 60	₹ 720	₹ 460
Total tax liability	**Nil**	**₹ 1,560**	**₹ 18,720**	**₹ 11,960**

Notes:

1. Since Mrs. B and Mr. D are non-residents, they cannot avail the higher basic exemption limit of ₹ 3,00,000 and ₹ 5,00,000 for persons over the age of 60 years and 80 years, respectively.
2. Since Mr. A is a resident whose total income does not exceed ₹ 5 lakhs, he is eligible for rebate of ₹ 12,500 or the actual tax payable, whichever is lower, under section 87A

Question 21

Hari has acquired a residential house property in Delhi on 15th April, 2002 for ₹ 9,00,000 and decided to sell the same on 3rd May, 2005 to Ms. Pari and an advance of ₹ 25,000 was taken from her. The balance money was not paid by Ms. Pari and Hari has forfeited the entire advance sum. On 3rd June, 2019, he has sold this house to Mr. Suri for ₹ 40,00,000. In the meantime, on 4th April, 2019, he had purchased a residential house in Delhi for ₹ 8,00,000, where he was staying with his family on rent for the last 5 years and paid the full amount as per the purchase agreement. However, Hari does not possess any legal title till 31st March, 2020, as such transfer was not registered with the registration authority.

Hari has purchased another old house in Chennai on 14th October, 2019 from Mr. X, an Indian resident, by paying ₹ 5,00,000 and the purchase was registered with the appropriate authority.

Determine the taxable capital gain arising from above transactions in the hands of Hari for Assessment Year 2020-21.

[Cost inflation Index - 2002-03: 105; 2005-06: 117; 2019-20: 289]

Answer

Computation of taxable capital gain of Mr. Hari for the A.Y.2020-21

Particulars	₹
Sale proceeds	40,00,000
Less: Indexed cost of acquisition **(See Note 1)**	24,08,333
Long Term Capital Gain	15,91,667
Less: Exemption under section 54 in respect of investment in house at Delhi **(See Note 2)**	8,00,000
Exemption under section 54 in respect of investment in house at Chennai **(See Note 3)**	5,00,000
Taxable long-term capital gain	**2,91,667**

Notes:

1. Computation of indexed cost of acquisition

Particulars	₹
Cost of acquisition	9,00,000
Less: Advance taken and forfeited	25,000
Cost for the purpose of Indexation	8,75,000
Indexed cost of acquisition (₹ 8,75,000 x 289/105)	24,08,333

Note: Advance received and forfeited on or after 01.04.2014 is taxable under section 56(2)(ix). Such amount would not be reduced to compute indexed cost of acquisition while determining capital gains on sale of such property.

However, in this case, since the advance was received and forfeited in the year 2005, such advance has to be reduced for calculating indexed cost of acquisition for the purpose of arriving at capital gains.

2. In order to avail exemption of capital gains under section 54, residential house should be purchased within 1 year before or 2 years after the date of transfer or constructed within a period of 3 years after the date of transfer. In this case, Hari has purchased the residential house in Delhi within one year before the date of transfer and paid the full amount as per the

purchase agreement, though he does not possess any legal title till 31.3.2020 since the transfer was not registered with the registration authority. However, for the purpose of claiming exemption under section 54, holding of legal title is not necessary. If the taxpayer pays the full consideration in terms of the purchase agreement within the stipulated period, the exemption under section 54 would be available. It was so held in Balraj v. CIT(2002) 254 ITR 22 (Del.) and CIT v. Shahzada Begum (1988) 173 ITR 397 (A.P.).

3. As per section 54, since the amount of capital gain does not exceeds ₹ 2 crore, Mr. Hari can claim exemption thereunder in respect of investment made in two residential houses situated in India. However, if Mr. Hari exercises the option to claim exemption in respect of two residential houses in Delhi and Chennai in P.Y. 2019-20, he shall not be subsequently entitled to exercise the option for the same or any other assessment year.

Question 22

The proprietary firm of "Mr. Amolak" a practicing Chartered Accountant, was converted into partnership on 01.09.2019 when his son joined him in the firm for 50% share. All the assets and liabilities of the erstwhile proprietary firm were transferred into the newly constituted partnership firm.

"Mr. Amolak" was credited and paid an amount of ₹ 5 lacs in his account from the firm. Explain as to chargeability of this amount of ₹ 5 lacs in the hands of "Mr. Amolak" when it stands paid for:

(i) transfer of business into partnership;

(ii) goodwill by the incoming partner.

Answer

(i) If the amount was paid for transfer of business/ profession to partnership

As per section 45(3), the profits and gains arising from the transfer of a capital asset by a person to the firm in which he becomes a partner shall be chargeable to tax as the income of the previous year which such transfer takes place. The amount recorded in the books of account of the firm would be deemed to be the full value of consideration received or accruing as a result of transfer of the capital asset.

Since in this case, consideration of ₹ 5 lacs **is received for such transfer**, profit or gain accrues to the transferor for the purposes of section 45. The amount of ₹ 5 lacs would be the full value of consideration received as a result of transfer and the capital gains resulting from this transfer would be chargeable to tax.

(ii) If the amount is paid by the incoming partner for Goodwill

The Supreme Court, in CIT v. B.C. Srinivasa Setty (1981) 128 ITR 294, observed that the income chargeable to capital gains tax is to be computed by deducting from the full value of consideration "the cost of acquisition of the capital asset". If it is not possible to ascertain the cost of acquisition, then, transfer of such asset is not chargeable to tax.

Section 55(2)(a) provides that the cost of acquisition of certain self-generated assets, including goodwill of a business, is Nil. Therefore, in respect of these self-generated assets covered under section 55(2)(a), the decision of the Supreme Court in B.C. Srinivasa Setty's case would not apply. However, in respect of other self-generated assets, including goodwill of profession, the decision of the Supreme Court in B.C. Srinivasa Setty's case, would continue to be applicable.

In effect, in case of self-generated assets not covered under section 55(2)(a), since the cost is not ascertainable, there would be no capital gains tax liability.

Therefore, in this case, since the consideration of ₹ 5 lakhs is paid towards goodwill of a profession, whose cost is NOT to be taken as 'Nil' since it is not covered under section 55(2)(a), the liability to capital gains tax will not arise.

Question 23

Mr. Ganesh sold his residential house in Mumbai and earned long term capital gain of 2.5 crores. He purchased two residential flats adjacent to each other on the same day vide two separate registered sale deeds from two different persons. The builder had certified that he had effected necessary modification to make it one residential apartment. Mr. Ganesh sought exemption under section 54 in respect of the investment made in purchase of the two residential flats. The Assessing Officer, however, gave exemption under section 54 to the extent of purchase of one residential flat only contending that since the long term capital gain exceeds ₹ 2 crore, sub-section (1) of section 54 clearly restricts the benefit of exemption to purchase one residential house only and the two flats cannot be treated as one residential unit since –

(i) the flats were purchased through different sale deeds; and

(ii) it was found by the Inspector that, before its sale to the assessee, the residential flats were in occupation of two different tenants.

Examine the correctness of the contention of the Assessing Officer.

Answer

This issue came up before the Karnataka High Court in CIT v. D. Ananda Basappa (2009) 309 ITR 329. The Court observed that the assessee had shown that the flats were situated side by side and the builder had also certified that he had effected modification of the flats to make them one unit by opening the door between the apartments. Therefore, it was immaterial that the flats were occupied by two different tenants prior to sale or that it was purchased through different sale deeds. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats as one unit. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one residential house.

Applying the ratio of the above decision to the case on hand, Mr. Ganesh is entitled to exemption under section 54 in respect of purchase of two flats to form **one residential house**. Therefore, the contention of the Assessing Officer is not correct.

Question 24

Vijay, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year relevant to the assessment year 2020-21. Within a month from the date of such sale, the four brothers executed a release deed in respect of their shares in the co--owned residential house in favour of Vijay for a monetary consideration.

Vijay utilised the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his four brothers. Vijay is not using the house, in respect of which his brothers executed a release deed, for his own residential purposes, but has let it out to another person, who is using it for his residential purposes.

Is Vijay eligible for exemption under section 54 of the Income-tax Act, 1961 for the assessment year 2020-21 in respect of the long-term capital gain arising from the sale of his residential house, which he utilised for acquiring the shares of his brothers in the co-owned residential house? Will the non-use of the new house for his own residential purposes disentitle him to exemption?

Answer

The long-term capital gain arising on sale of residential house would be exempt under section 54 if it is utilized, inter alia, for purchase of one residential house situated in India within one year before or two years after the date of transfer. Release by the other co-owners of their share in co-owned property in favour of Vijay would amount to "purchase" by Vijay for the purpose of claiming exemption under section 54 [CIT v. T.N. Arvinda Reddy (1979) 120 ITR 46 (SC)]. Since such purchase is within the stipulated time of two years from the date of transfer of asset, Vijay is eligible for exemption under section 54. As Vijay has utilised the entire long-term capital gain arising out of the sale of the residential house for payment of consideration to the other co-owners who have released their share in his favour, he can claim full exemption under section 54.

There is no requirement in section 54 that the new house should be used by the assessee for his own residence. The condition stipulated is that the new house should be utilised for residential purposes and its income is chargeable under the head "Income from house property". This requirement would be satisfied even when the new house is let out for residential purposes.

Question 25

Aries Tubes Private Ltd. went into liquidation on 01.06.2019. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

	₹
Share Capital (issued on 01.04.2013)	5,00,000
Reserves prior to 1.6.2019	3,00,000
Excess realization in the course of liquidation	5,00,000
Total	**13,00,000**

There are 5 shareholders, each of whom received ₹ 2,60,000 from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital gain in long term specified assets as defined in section 54EC. You are required to examine the various issues and advice the shareholders about their liability to income tax.

Answer

Under section 46(1), where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as transfer in the hands of the company for the purpose of section 45.

However, under section 46(2), where the shareholder, on liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head "capital gains", in respect of the money so received or the market value of the other assets on the date of distribution as reduced by the amount of dividend deemed under section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

As per section 2(22)(c), dividend includes any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not.

In this case, the accumulated profits immediately before liquidation is ₹ 3,00,000. The share of each shareholder is ₹ 60,000 (being one-fifth of ₹ 3,00,000). An amount of ₹ 60,000 is the deemed dividend under section 2(22)(c). The same is exempt under section 10(34) in the hands of the shareholder, since the company is liable to dividend distribution tax in respect of the same[7].

Therefore, ₹ 2,00,000 [i.e. ₹ 2,60,000 minus ₹ 60,000, being the deemed dividend under section 2(22)(c)] is the full value of consideration in the hands of each shareholder as per section 46(2). Against this, the investment of ₹ 1,00,000 by each shareholder is to be deducted to arrive at the capital gains of ₹ 1,00,000 of each shareholder. The benefit of indexation is available to the shareholders (since the shares are held for more than 24 months and hence long-term capital asset), but could not be computed in the absence of required information. Since the equity shares are not listed, it would not be liable for securities transaction tax and hence, the capital gain (long term) would be taxable under section 112. The benefit of concessional rate of tax @10% without indexation would also not be available. Hence, such long term capital gain would be taxable @20% with indexation benefit.

Exemption under section 54EC is available only where there is an actual transfer of capital assets and not in the case of deemed capital gain as per the decision rendered in the case of CIT v. Ruby Trading Co (P) Ltd (2003) 259 ITR 54 (Raj). Therefore, exemption under section 54EC will not be available in this case since it is deemed transfer and not actual transfer. Furthermore, with effect from A.Y. 2019-20, exemption under section 54EC is available only on transfer of long-term capital asset, being land or building or both.

Question 26

Xavier had taken a loan under registered mortgage deed against the house, which was purchased by him on 26.05.2002 for ₹ 5 lacs. The said property was inherited by his son Abraham in financial year 2009-10 as per Will.

For obtaining a clear title thereof, Abraham paid the outstanding amount of loan on 12.02.2010 of ₹ 15 lacs. The said house property was sold by Abraham on 16.03.2020 for ₹ 50 lacs. Examine with reasons the amount chargeable to capital gains for A.Y. 2020-21

(Cost Inflation Index 2002-03: 105, 2009-10: 148 and 2019-20: 289).

Answer

The cost of inherited property to Mr. Abraham shall be the cost to the previous owner as per provisions of section 49(1)(iiia) and therefore, ₹ 5 lacs, being the cost to his father (amount paid by his father on 26.5.2001 for acquiring the property) shall be the cost to Mr. Abraham, who is the new owner. Payment of outstanding loan of the predecessor by the successor for obtaining a clear title of the property by release of Mortgage Deed shall be the cost of acquisition of the successor under section 48 read with section 55(2) of the Act as held by the Apex Court in case of RM. Arunachalam v. CIT [1997] 227 ITR 222.

Computation of Taxable Capital Gain for the A.Y. 2020-21

Particulars		₹
Sale consideration of house property		50,00,000
Less: **Indexed cost of acquisition (See Note below)**		
(i) Cost to previous owner (₹ 5,00,000 × 289/148)	9,76,351	
(ii) Loan amount paid by Mr. Abraham (Benefit of CII is available since the loan amount was paid in the financial year 2009-10) (₹ 15,00,000 × 289/148)	29,29,054	39,05,405
Capital gains		**10,94,595**

Note: Since the property was acquired by Mr. Abraham through inheritance, the cost of acquisition will be cost to the previous owner.

As per the definition of indexation cost of acquisition under clause (iii) of Explanation below section 48, indexation benefit will be available only from the previous year in which Abraham first held the asset i.e. P.Y. 2009-10.

However, as per the view expressed by Bombay High Court, in the case of CIT v. Manjula J. Shah (2013) 355 ITR 474, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would be ₹ 43,05,244 (₹ 13,76,190 + ₹ 29,29,054) and long term capital gain would be ₹ 6,94,756.

Question 27

Gama Ltd, located within the corporation limits decided in December, 2019 decided to shift its industrial undertaking to non-urban area. The company sold some of the assets and acquired new assets in the process of shifting. The relevant details are as follows:

				(₹ in lacs)	
	Particulars	**Land**	**Building**	**Plant & Machinery**	**Furniture**
(i)	Sale proceeds (sale effected in March, 2020)	8	18	16	3
(ii)	Indexed cost of acquisition	4	10	12	2
(iii)	WDV in terms of section 50	--	4	5	2
(iv)	Cost of new assets purchased in July, 2020 for the purpose of business in the new place	4	7	17	2

Compute the capital gains of Gama Ltd for the assessment year 2020-21.

Answer

Section 54G deals with deduction in respect of any capital gain that may arise from the transfer of an industrial undertaking situated in an urban area in the course of or in consequence of shifting to a non-urban area.

If the assessee purchases new machinery or plant or acquires a building or land or constructs a new building or shifts the original asset and transfers the establishment to the new area, within 1 year before or 3 years after the date on which the transfer takes place, then, instead of the capital gain being charged to tax, it shall be dealt with as under:

1. If the capital gain is greater than the cost of the new asset, the difference between the capital gain and the cost of the new asset shall be chargeable as income 'under section 45'.
2. If the capital gain is equal to or less than the cost of the new asset, section 45 is not to be applied.

The capital assets referred to in section 54G are machinery or plant or land or building or any rights in building or land. Capital gain arising on transfer of furniture does not qualify for exemption under section 54G. No exemption is therefore available under section 54G in respect of investment of ₹ 2 lacs in acquiring furniture.

The first step therefore is to determine the capital gain arising out of the transfer and thereafter apply the provisions of section 54G.

	Particulars	**₹**
(a)	**Land** – Sale proceeds (Non-depreciable asset)	8,00,000

	Less: Indexed cost of acquisition	4,00,000
	Long term capital gain	4,00,000
	Less: Cost of new assets purchased within three year after the date of transfer (under section 54G) **(See Note below)**	3,00,000
	Taxable Long term capital gain	**1,00,000**
(b)	**Building** – sale proceeds (depreciable assets)	18,00,000
	Less: W.D.V. is deemed as cost of acquisition under section 50	4,00,000
	Short term capital gain	**14,00,000**
(c)	**Plant & machinery-** sale proceeds (depreciable asset)	16,00,000
	Less: WDV is deemed cost under section 50	5,00,000
	Short term capital gain	**11,00,000**
(d)	**Furniture -** sale proceeds (depreciable asset)	3,00,000
	Less: WDV is deemed cost under section 50	2,00,000
	Short term capital gain **(A)**	**1,00,000**

Summary	**₹**
Short term capital gain : Building	14,00,000
Short term capital gain : Plant & machinery	11,00,000
	25,00,000
Less: Section 54G [New assets purchased] **(See Note below)**	25,00,000
Net short term capital gain **(B)**	**Nil**
Total short term capital gain (A)+(B) = ₹ 1 lac	

Note – Total exemption available under section 54G is ₹ 28 lacs (₹ 4 lacs + ₹ 7 lacs + ₹ 17 lacs). The exemption should first be exhausted against short term capital gain as the incidence of tax in case of short-term capital gain is more than in case of long term capital gain. Therefore, ₹ 25 lacs is exhausted against short term capital gain and the balance of ₹ 3 lacs against long term capital gain.

The taxable capital gains would be:

Long term capital gains	₹ 1,00,000 (taxable @20% under section 112)
Short term capital gains (furniture)	₹ 1,00,000 (taxable @30%/25%, as the case may be)
	₹ 2,00,000

Question 28

The assessee was a company carrying on business of manufacture and sale of art-silk cloth. It purchased machinery worth ₹ 4 lacs on 1.5.2008 and insured it with United India Assurance Ltd against fire, flood, earthquake etc., The written down value of the asset as on 01.04.2019 was ₹ 2,08,800. The insurance policy contained a reinstatement clause requiring the insurance company to pay the value of the machinery, as on the date of fire etc., in case of destruction of loss. A fire broke out in August, 2019 causing extensive damage to the machinery of the assessee rendering them totally useless. The assessee company received a sum of ₹ 6 lacs from the insurance company on 15th March, 2020. Discuss the issues arising on account on the transactions and their tax treatment.
(Cost inflation index for financial year 2008-09 and 2019-20 are 137 and 289 respectively)

Answer

As per section 45(1A), where any person receives any money or other assets under an insurance from an insurer on account of damage to or destruction of capital asset as a result of, inter alia, accidental fire then, any profits and gains arising from the receipt of such money or other assets, shall be chargeable to income tax under the head "Capital Gains" and shall be deemed to be the income of such person of the previous year in which such money or asset was received.

For the purpose of section 48, the money received or the market value of the asset shall be deemed to be the full value of the consideration accruing as a result of the transfer of such capital asset. Since the asset was destroyed and the money from the insurance company was received in the previous year, there will be a liability to capital gains in respect of the insurance moneys received by the assessee.

Under section 45(1A) any profits and gains arising from receipt of insurance moneys is chargeable under the head "Capital gains". For the purpose of section 48, the moneys received shall be deemed to be the full value of the consideration accruing or arising. Under section 50 the capital gains in respect of depreciable assets had to be computed in the following manner (**assuming it was the only asset in the block**).

The computation of capital gain and tax implication is given below:

Full value of the consideration	₹ 6,00,000
Less: Written down value as on April 1st, 2019	₹ 2,08,800
Short term capital gains	₹ 3,91,200

Question 29

Tani purchased a land at a cost of ₹ 35 lakhs in the financial year 2004-05 and held the same as her capital asset till 31st May, 2018. Tani started her real estate business on 1st June, 2018 and converted the said land into stock-in-trade of her business on the said date, when the fair market value of the land was ₹ 210 lakhs.

She constructed 15 flats of equal size, quality and dimension. Cost of construction of each flat is ₹ 10 lakhs. Construction was completed in January, 2020. She sold 10 flats at ₹ 30 lakhs per flat between January, 2020 and March, 2020. The remaining 5 flats were held in stock as on 31st March, 2020.

She invested ₹ 50 lakhs in bonds issued by National Highway Authority of India on 31st March, 2020 and another ₹ 50 lakhs in bonds of Rural Electrification Corporation Ltd. in April, 2020.

Compute the amount of chargeable capital gain and business income in the hands of Tani arising from the above transactions for Assessment Year 2020-21 indicating clearly the reasons for treatment for each item.

Cost Inflation Index: FY 2004-05: 113; FY 2018-19: 280; FY 2019-20: 289.

Answer

Computation of capital gains and business income of Tani for A.Y. 2020-21

Particulars	₹
Capital Gains	
Fair market value of land on the date of conversion deemed as the full value of consideration for the purposes of section 45(2)	2,10,00,000
Less: Indexed cost of acquisition [₹ 35,00,000 × 280/113]	86,72,566
	1,23,27,434

Proportionate capital gains arising during A.Y.2020-21 [₹1,23,27,434 × 2/3]	82,18,289
Less: Exemption under section 54EC	50,00,000
Capital gains chargeable to tax for A.Y.2020-21	32,18,289
Business Income	
Sale price of flats [10 × ₹ 30 lakhs]	3,00,00,000
Less: Cost of flats	
Fair market value of land on the date of conversion [₹ 210 lacs × 2/3]	1,40,00,000
Cost of construction of flats [10 × ₹ 10 lakhs]	1,00,00,000
Business income chargeable to tax for A.Y.2020-21	**60,00,000**

Notes:

(1) The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock-in-trade.

(2) However, as per section 45(2), the capital gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock-in-trade is sold.

(3) The indexation benefit for computing indexed cost of acquisition would, however, be available only up to the year of conversion of capital asset to stock-in-trade and not up to the year of sale of stock-in-trade.

(4) For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

(5) In this case, since only 2/3rd of the stock-in-trade (10 flats out of 15 flats) is sold in the P.Y.2019-20, only proportionate capital gains (i.e., 2/3rd) would be chargeable in the A.Y.2020-21.

(6) On sale of such stock-in-trade, business income would arise. The business income chargeable to tax would be computed after deducting the fair market value on the date of conversion of the capital asset into stock-in-trade and cost of construction of flats from the price at which the stock- in-trade is sold.

(7) In case of conversion of capital asset into stock-in-trade and subsequent sale of stock-in- trade, the period of 6 months is to be reckoned from the date of sale of stock-in-trade for the purpose of exemption under section 54EC [CBDT Circular No.791 dated 2.6.2000]. In this case, since the investment in bonds of NHAI has been made within 6 months of sale of flats, the same qualifies for exemption under section 54EC. With respect to long-term capital gains arising in any financial year, the maximum deduction under section 54EC would be ₹ 50 lakhs, whether the investment in bonds of NHAI or RECL are made in the same financial year or next financial year or partly in the same financial year and partly in the next financial year.

Therefore, even though investment of ₹ 50 lakhs has been made in bonds of NHAI during the P.Y.2019-20 and investment of ₹ 50 lakhs has been made in bonds of RECL during the P.Y.2020-21, both within the stipulated six month period, the maximum deduction allowable for A.Y.2020-21, in respect of long-term capital gain arising on sale of long-term capital asset(s) during the P.Y.2019-20, is only ₹ 50 lakhs.

Question 30

X Limited has transferred its Unit N to Y Limited by way of slump sale on November 30, 2019. The summarised Balance Sheet of X Limited as on that date is given below:

Liabilities	₹ (in lakhs)	Assets	₹ (in lakhs)
Paid up capital	1,700	Fixed Assets :	
Reserve & surplus	620	Unit L	150
Liabilities:		Unit M	150
Unit L	40	Unit N	550
Unit M	110	Other Assets:	
Unit N	90	Unit L	520
		Unit M	800
		Unit N	390
Total	**2,560**	**Total**	**2,560**

Using the further information given below, compute the capital gain arising from slump sale of Unit N and tax on such capital gain.

(i) Lump sum consideration on transfer of Unit N is ₹ 880 lakhs.

(ii) Fixed assets of Unit N include land which was purchased at ₹ 60 lakhs in August 2007 and revalued at ₹ 90 lakhs as on March 31, 2019.

(iii) Other fixed assets are reflected at ₹ 460 lakhs (i.e. ₹ 550 lakhs less value of land) which represents written down value of those assets as per books. The written down value of these assets under section 43(6) of the Income-tax Act, 1961 is ₹ 410 lakhs.

(iv) Unit N was set up by X Limited in July, 2007.

(v) Cost inflation index for financial year 2007-08 and financial year 2019-20 are 129 and 289, respectively.

Answer

Computation of capital gain on slump sale of Unit N under section 50B

Particulars	₹ (in lacs)
Sale consideration for the slump sale of Unit N	880
Less: Net worth of Unit N (Refer Note 1 below)	770
Long term capital gain arising on slump sale	**110**

Computation of tax liability of X Ltd. on slump sale of Unit N

Particulars	₹ (in lacs)
Tax on capital gains@20%	22.00
Add: Surcharge@7%	1.54
	23.54
Add: Health and Education cess @4%	0.94
Total tax liability on capital gain arising on slump sale of Unit N	**24.48**

Notes:

1. The net worth of an undertaking transferred by way of slump sale shall be deemed to the cost of acquisition and cost of improvement for the purposes of section 48 and 49 [Section 50B(2)].

Computation of net worth of Unit N

Particulars	₹ (in lacs)
(A) Book value of non-depreciable assets:	
(i) Land (Revaluation is to be ignored for computing net worth)	60
(ii) Other assets	390
(B) Written down value of depreciable assets under section 43(6)	410
Aggregate value of total assets	860
Less: Value of liabilities of Unit N	90
Net worth of Unit N	**770**

2. Since Unit N is held for more than 36 months, the capital gains of ₹ 110 lacs arising on transfer of such unit would be a long term capital gain taxable under section 112. However, indexation benefit is not available in the case of a slump sale.

Question 31

Following are the details of income provided by Mr. Singh, the assessee for the financial year ended 31st March, 2020:

(i) Rental income from property at Bangalore - ₹ 3 lakhs, Standard Rent - ₹ 2,50,000, Fair Rent - ₹ 2,80,000.

(ii) Municipal and water tax paid during 2019-20: Current year ₹ 35,000, Arrears - ₹ 1,50,000.

(iii) Interest on loan borrowed towards major repairs to the property: ₹ 1,50,000.

(iv) Arrears of rent of ₹ 30,000 received during the year, which was not charged to tax in earlier years.

Further, the assessee furnished following additional information regarding sale of property at Chennai:

(i) Mr. Singh's father acquired a residential house in April 2006 for ₹ 1,25,000 and thereafter gifted this property to the assessee, Mr. Singh on 1st March, 2007.

(ii) The property, so gifted, was sold by Mr. Singh on 10th June 2019. The consideration received was ₹ 25,00,000.

(iii) Stamp duty charges paid by the purchaser at the time of registration @ 13% (as per statutory guidelines) was ₹ 3,90,000.

(iv) Out of the sale consideration received:

(a) On 02/01/2020, the assessee had purchased two adjacent flats, in the same building, and made suitable modification to make it as one unit. The investment was made by separate sale deeds, amount being ₹ 8,00,000 and ₹ 7,00,000, respectively.

(b) On 10/l0/2019, ₹ 10 lakhs was invested in bonds issued by National Highways Authority of India, but the allotment of the bonds was made on 1.2.2020.

Compute Mr. Singh's taxable income for assessment year 2020- 21.

Cost inflation index: F.Y. 2006-07: 122; F.Y. 2019-20: 289

Answer

Computation of taxable income of Mr. Singh for A.Y.2020-21

Particulars	₹	₹
Income from house property		
Gross Annual Value [Higher of Expected Rent & Actual Rent]		3,00,000
Expected Rent [lower of Fair Rent and Standard Rent]	2,50,000	
Actual Rent	3,00,000	
Less: Municipal taxes paid by Mr. Singh during the year (including arrears) [₹ 35,000 + ₹1,50,000]		1,85,000
Net Annual Value (NAV)		1,15,000
Less: Deductions under section 24		
(a) 30% of NAV	34,500	
(b) Interest on loan borrowed for major repairs	1,50,000	1,84,500
		(69,500)
Arrears of rent taxable under section 25A	30,000	
Less: Deduction@30%	9,000	21,000
		(48,500)
Capital Gains		
Full value of consideration		30,00,000
As per section 50C, the full value of consideration would be the higher of -		
Actual Consideration	25,00,000	
Stamp Duty Value [₹ 3,90,000/13%]	30,00,000	
Since stamp duty value > 105% of actual consideration		
Less: **Indexed cost of acquisition** [₹ 1,25,000 × 289/122]		
As per section 49(1), cost of acquisition of the residential house gifted by Mr. Singh's father to Mr. Singh would be the cost for which Mr. Singh's father acquired the asset		2,96,107
		27,03,893
Less: **Exemption under section 54 (₹ 8,00,000 + ₹ 7,00,000)**		
Purchase of residential house within the stipulated time (within one year before or two years after the date of sale) [Where the flats are situated side by side and the builder had effected the necessary modification to make it as one house, the assessee would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds]		
[CIT v. Ananda Basappa (2009) 331 ITR 211 (Kar.)]	15,00,000	
Note: Since two adjacent flats are treated as one residential house, Mr. Singh can defer availing exemption under section 54 in respect of two residential houses (where capital gains does not exceed ₹ 2 crores) to a later assessment year.		

Exemption under section 54EC		
Investment in bonds of NHAI within six months from the date of transfer. Where the payment for bonds has been made within the six month period, exemption under section 54EC would be available even if the allotment of bonds was made after the expiry of the six months [Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)]	10,00,000	25,00,000
Long-term capital gains		2,03,893
Total Income		**1,55,393**

Question 32

SS(P) Ltd., an Indian company having two undertakings engaged in manufacture of cement and steel, decided to hive off cement division to RV(P) Ltd., an Indian company, by way of demerger. The net worth of SS(P) Ltd. immediately before demerger was ₹ 40 crores. The net book value of assets transferred to RV(P) Ltd. was ₹ 10 crores. The demerger was made in January 2020. In the scheme of demerger, it was fixed that for each equity share of ₹ 10 each (fully paid up) of SS(P) Ltd., two equity shares of ₹ 10 each (fully paid up) were to be issued.

One Mr. N.K. held 25,000 equity shares in SS(P) Ltd. which were acquired in the financial year 2004-05 for ₹ 6,00,000. Mr. N.K. received 50,000 equity shares from RV(P) Ltd. consequent to demerger in January 2020. He sold all the shares of RV(P) Ltd. for ₹ 8,00,000 in March, 2020. In this background you are requested to answer the following:

(i) Does the transaction of demerger attract any income tax liability in the hands of SS(P) Ltd. and RV(P) Ltd.?

(ii) Compute the capital gain that could arise in the hands of Mr. N.K. on receipt of shares of RV(P) Ltd.

(iii) Compute the capital gain that could arise in the hands of Mr. N.K. on sale of shares of RV(P) Ltd.

(iv) Will the sale of shares by Mr. N.K. affect the tax benefits availed by SS(P) Ltd. and/or RV(P) Ltd.?

(v) Is Mr. N.K. eligible to avail any tax exemption under any of the provisions of the Income-tax Act, 1961 on the sale of shares of RV(P) Ltd.? If so, mention in brief.

Note:	Financial Year	Cost inflation index
	2004-05	113
	2019-20	289

Answer

(i) No, the transaction of demerger would not attract any income-tax liability in the hands of SS(P) or RV(P) Ltd.

As per section 47(vib), any transfer in a demerger, of a capital asset, by the demerged company to the resulting company would not be regarded as "transfer" for levy of capital gains tax if the resulting company is an Indian company.

Hence, capital gains tax liability would not be attracted in the hands of SS(P) Ltd., the demerged company, in this case, since RV(P) Ltd. is an Indian company

(ii) There would be no capital gains liability in the hands of Mr. N.K. on receipt of shares of RVP Ltd., since as per section 47(vid), any issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company will not be regarded as "transfer" for levy of capital gains tax, if the issue is made in consideration of demerger of the undertaking.

(iii) Yes, capital gains would arise in the hands of Mr. N.K. on sale of shares of RV (P) Ltd.

Sale consideration	8,00,000
Less: Indexed cost of acquisition of shares of RV (P) Ltd.	
Cost of acquisition of shares of RV(P) Ltd. as per section 49(2C):	
Indexed cost of acquisition of shares of RV (P) Ltd. [₹ 1,50,000 × 289/113]	₹ 3,83,628
Long-term capital gain (since period of holding of shares in demerged company is also to be considered)	**₹ 4,16,372**

$$\text{Cost of acquisition of shares of SS(P) Ltd.} \times \frac{\text{Net book value of assets transferred in a demerger}}{\text{Net worth of the demerged company immediately before demerger}}$$

$$`6,00,000 \times \frac{10 \text{ crore}}{40 \text{ crore}} = `1,50,000$$

(iv) No, sale of shares by Mr. N.K. would not affect the tax benefits availed by SS(P) Ltd. or RV[Ltd. One of the conditions to be satisfied is that the shareholders holding not less than three-fourths in value of the shares in the demerged company become shareholders of the resulting company by virtue of the demerger. It is presumed that the condition is satisfied in this case.

There is no stipulation that they continue to remain shareholders for any period of time thereafter.

(v) Since the resultant capital gain on sale of shares of RV(P) Ltd. is a long-term capital gain (on account of the period of holding of shares in demerged company being considered by virtue of section 2(42A)(g)), Mr. N.K. can avail exemption –

(1) under section 54EE, by investing the long-term capital gain units of specified fund, within a period of 6 months from the date of transfer.

(2) under section 54F by investing the entire net consideration in purchase (within one year before and two years after the date of transfer) or construction (within three years after the date of transfer) of one residential house in India. If part of the net consideration is invested, only proportionate exemption would be available.

Question 33

The Balance sheet of JB Opticals Limited as on 31-03-2020 reads as under:

Paid up capital ₹ 2,52,00,000

	Unit A (₹)	Unit B (₹)
Fixed assets	1,00,00,000	1,50,00,000
Debtors	1,00,00,000	75,00,000
Liabilities	28,00,000	50,00,000
Stock in trade	50,00,000	25,00,000
Reserves		1,48,00,000
Share premium		22,00,000

The company acquired Unit B on 1.04.2017. They made certain capital additions in the form of Generator set and additional building etc., for ₹ 25 lacs during the year 2017-18. The members of

the company have authorized the Board in their meeting held on 28.01.2020 to dispose of Unit 'B'. The company decides to sell Unit 'B' by way of slump sale for ₹ 225 lacs as consideration. The buyer is keen on buying the unit at the earliest, preferably before 31.3.2020. JB Opticals Ltd. has offered 4% discount if the buyer closes the sale and makes payment between 1.4.2020 and 30.4.2020, since the company would be able to avail benefit of concessional rate of tax on long-term capital gains. Accordingly, this discount would not be available if the sale is completed (and payment is made) before 31.03.2020. You are required to advise the company as a measure of tax planning to determine the date of sale keeping in view the capital gains tax. Assume that the written down value of the fixed assets as per section 43(6) is ₹ 120 lacs.

Would your answer change if the buyer is ready to accept discount of 3%, other facts remaining the same?

Note: Total turnover for the P.Y. 2017-18 was ₹ 450 crore.

Answer

Determination of net worth of Unit B of M/s. J.B. Opticals Ltd.

	₹ (in lacs)
Written down value of fixed assets	120
Debtors	75
Stock-in-trade	25
	220
Less : Liabilities	50
Net worth	**170**

Comparative calculation of chargeable capital gains

	Sale before 31.3.2020	**Sale after 31.03.2020**
Sale consideration	2,25,00,000	2,25,00,000
Less: Discount	Nil	9,00,000
Net sale consideration	2,25,00,000	2,16,00,000
Less: Net worth	1,70,00,000	1,70,00,000
Short term capital gain	55,00,000	N.A.
Long term capital gain	N.A.	46,00,000
Tax rate	31.2%	20.8%
Tax thereon	**17,16,000**	**9,56,800**

Computation of Net Cash flow

	Sale before 31.3.2020	**Sale after 31.03.2020**
Net sale consideration	2,25,00,000	2,16,00,000
Less: Income-tax	17,16,000	9,56,800
Net Cash flow	**2,07,84,000**	**2,06,43,200**

Note: The assessee is advised to effect slump sale before 31.03.2020 as the net cash flow arising from sale effected before 31.03.2020 is higher than the net cash flow arising from sale effected after 31.03.2020, inspite of the higher rate of tax on short-term capital gains.

Alternate Situation: If the buyer is ready to accept discount of 3% offered by J.B. Opticals Ltd.

In this case, the capital gain tax and net cash flow would be as under:

Comparative calculation of chargeable capital gains

	Sale before 31.3.2020	Sale after 31.03.2020
Sale consideration	2,25,00,000	2,25,00,000
Less: Discount	Nil	6,75,000
Net sale consideration	2,25,00,000	2,18,25,000
Less: Net worth	1,70,00,000	1,70,00,000
Short term capital gain	55,00,000	N.A.
Long term capital gain	N.A.	48,25,000
Tax rate	31.2%	20.8%
Tax thereon	**17,16,000**	**10,03,600**

Computation of Net Cash flow

	Sale before 31.3.2020	Sale after 31.03.2020
Net sale consideration	2,25,00,000	2,18,25,000
Less: Income-tax	17,16,000	10,03,600
Net Cash flow	**2,07,84,000**	**2,08,21,400**

Note: In case the buyer is ready to accept discount of 3%, the assessee can effect slump sale after 31.03.2020 as the net cash flow arising from sale effected after 31.03.2020 is higher than the net cash flow arising from sale effected before 31.03.2020.

Question 34

PQR Limited has two units - one engaged in manufacture of computer hardware and the other involved in developing software. As a restructuring drive, the company has decided to sell its software unit as a going concern by way of slump sale for ₹ 385 lacs to a new company called S Limited, in which it holds 74% equity shares.

The balance sheet of PQR limited as on 31st March 2020, being the date on which software unit has been transferred, is given hereunder –

Balance Sheet as on 31.3.2020

Liabilities	₹ (in lacs)	Assets	₹ (in lacs)
Paid up Share Capital	300	Fixed Assets	
General Reserve	150	Hardware unit	170
Share Premium	50	Software unit	200
Revaluation Reserve	120	Debtors	
Current Liabilities		Hardware unit	140
Hardware unit	40	Software unit	110
Software unit	90	Inventories	
		Hardware unit	95
		Software unit	35
	750		**750**

Following additional information are furnished by the management:

(i) The Software unit is in existence since May, 2015.

(ii) Fixed assets of software unit includes land which was purchased at ₹ 40 lacs in the year 2008 and revalued at ₹ 60 lacs as on March 31, 2020.

(iii) Fixed assets of software unit mirrored at ₹ 140 lacs (₹ 200 lacs minus land value ₹ 60 lacs) is written down value of depreciable assets as per books of account. However, the written down

value of these assets under section 43(6) of the Income-tax Act, 1961 is ₹ 90 lacs.

(a) Ascertain the tax liability, which would arise from slump sale to PQR Limited.

(b) What would be your advice as a tax-consultant to make the restructuring plan of the company more tax-savvy, without changing the amount of sale consideration?

Answer

(a) As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer tookplace.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability of PQR Limited from slump sale of software unit

Particulars	₹ (in lacs)
Sale consideration for slump sale of Software Unit	385
Less: Cost of acquisition, being the net worth of Software Unit	185
Long term capital gains arising on slump sale	**200**
(The capital gains is long-term as the Software Unit is held for more than 36 months)	
Tax liability on LTCG	
Under section 112 @ 20% on ₹ 200 lacs	40.00
Add: Surcharge@ 7%	2.80
	42.80
Add: Health and Education cess@4%	1.712
	44.512

Working Note:

Computation of net worth of Software Unit

	₹ (in lacs)
(1) Book value of non-depreciable assets	
(i) Land (Revaluation not to be considered)	40
(ii) Debtors	110
(iii) Inventories	35
(2) Written down value of depreciable assets under section 43(6) **(See Note below)**	90
Aggregate value of total assets	275
Less: Current liabilities of software unit	90
Net worth of software unit	**185**

Note : For computing net worth, the aggregate value of total assets in the case of depreciable assets shall be the written down value of the block of assets as per section 43(6).

(b) Tax advice

(i) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempt from capital gains under section 47(iv). Hence, PQR Limited should try to acquire the remaining 26% equity shares in S Limited then make the slump sale in the

above said manner, in which case the slump sale shall be exempt from tax. For this exemption, PQR Limited will have to keep such 100% holding in S Limited for a period of 8 years from the date of slump sale, otherwise the amount exempt would be deemed to be income chargeable under the head "Capital Gains" of the previous year in which such transfer took place.

(ii) Alternatively, if acquisition of 26% share is not feasible, PQR Limited may think about demerger plan of Software Unit to get benefit of section 47(vib) of the Income- tax Act, 1961.

Section B – Additional Questions

Question 35

Axel Ltd. has two industrial undertakings. Unit I is engaged in the production of television sets and Unit II is engaged in the production of refrigerators. The company has, as part of its restructuring program, decided to sell Unit II as a going concern by way of slump sale for ₹ 260 lacs to a new company called Gamma Ltd., in which it holds 85% equity shares. The following is the extract of the balance sheet of Axel Ltd. as on 31st March, 2020:

	₹ (in lacs)	
	Unit – I	**Unit – II**
Fixed Assets	112	158
Debtors	88	67
Inventories	60	23
Liabilities	33	45
		₹ (in lacs)
Paid-up share capital		231
General Reserve		160
Share Premium		39
Revaluation Reserve		105

The company set up Unit II on 1st April, 2015. The written down value of the block of assets for tax purpose as on 31st March, 2020 is ₹ 150 lacs of which ₹ 60 lacs are attributable to Unit II.

(i) Determine what would be the tax liability of Axel Ltd. on account of Slump sale;

(ii) How can the restructuring plan of Axel Ltd. be modified, without changing the amount of consideration, in order to make it more tax efficient?

Answer

(i) As per section 50B, any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability of Axel Ltd. from slump sale of Unit II

Particulars	**₹**
Slump sale consideration	2,60,00,000
Less : Cost of acquisition (net worth) [See Working Note below]	1,05,00,000
Long-term capital gain (as Unit II is held for more than 36 months)	**1,55,00,000**
Calculation of tax liability	
Income tax @ 20% (Being long term capital gain under section 112)	31,00,000
Surcharge @ 7%	2,17,000
	33,17,000
Education cess @ 4%	1,32,680
Total tax liability	**34,49,680**

Working Note: Net worth of Unit II

Particulars	**₹**

WDV of block of assets	60,00,000
Debtors	67,00,000
Inventories	23,00,000
	1,50,00,000
Less : Liabilities	45,00,000
Net worth	**1,05,00,000**

(ii) Tax Advice

(a) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempted from tax under section 47(iv). Therefore, if it is possible for Axel Ltd. should try to acquire the entire shareholding of Gamma Ltd. and thereafter make a slump sale, then the resultant capital gain shall not attract tax liability. However, in such case also, Axel Ltd. should not transfer any shares in Gamma Ltd. for 8 years from the date of slump sale.

(b) Alternatively, if acquisition of 15% share is not feasible, Axel Ltd. may think about demerger plan of Unit II to get benefit of section 47(vib) of the Income-tax Act, 1961.

Question 36

K and Co. (firm) had sold all its assets and liabilities as a slump sale on 31-03-2020 to SVPC & Co. (firm) for a lump sum consideration of ₹ 600 lakhs.
The statement of affairs of K & Co. as on 31-03-2020 is as below:

Liabilities	₹ (in lakhs)	Assets	₹ (in lakhs)	
Capital	1,627	Fixed Assets		
Unsecured Loans	25	Plant & Machinery at WDV	250	
Bank Borrowing	500	Land (At Revalued figure)	1,200	1,450
Sundry Creditors	80	Current Assets:		
		Sundry Debtors	380	
		Cash & Bank Balances	2	
		Loans & Advances	150	
		Closing Stock	250	782
Total	2,232	Total		2,232

Additional Information:

(1) Cost of land in March 2009 was ₹ 100 lakhs.
(2) WDV of Plant & Machinery u/s 43(6) was ₹ 200 lakhs.
(3) Cost Inflation Index for the financial year 2008-09 was 137 and for 2019-20 is 289.
(4) Stock is overvalued by 10%

Compute capital gain arising from slump sale and tax on such gain.

Answer

As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain.

In this case, it is assumed that the undertaking was set up in March 2009, being the period in which land was acquired. Hence, the resultant capital gain on slump sale is a long-term capital gain. However, as per section 50B(2), indexation benefit is not available in case of slump sale.

Computation of Capital Gain arising from slump sale and tax on such gain

Particulars	₹ in lakhs
Slump sale consideration	600.00
Less: Cost of acquisition (net worth) **[See Working Note below]**	454.27
Long-term capital gain	**145.73**
Income-tax @ 20% (under section 112)	29.146
Add: Surcharge@12%, since total income exceeds ₹1 crore.	3.498
	32.644
Add: Health & Education cess@4%	1.306
Total tax liability	**33.950**

Working Note: Computation of Net worth of the undertaking

Particulars	₹ in lakhs	
WDV of block of assets (Plant & Machinery) as per section 43(6)] Book value of non-depreciable assets		200.00
- Land (Revaluation not to be considered)	100.00	
- Sundry Debtors	380.00	
- Cash & Bank Balance	2.00	
- Loans & Advances	150.00	
- Closing Stock (₹ 250 lakhs – ₹ 22.73 lakhs, being the amount of over-valuation i.e., 10/110 × ₹ 250) [See Note below]		
	227.27	859.27
Less: Liabilities		1059.27
- Unsecured Loans		
- Bank Borrowing	25.00	
- Sundry Creditors	500.00	
Net worth	80.00	605.00

Note: Book value of assets (other than depreciable assets) has to be considered for the purpose of arriving at the net worth. Stock has to be valued at lower of cost or net realizable value as per AS 2 and this is the value to be reflected in the Balance Sheet of an entity. For this reason, the effect of over-valuation of stock has been removed while computing the net worth of the undertaking.

Question 37

Kala purchased a residential flat from her friend Bala at ₹ 10 lacs in the city of Jaipur on 3rd October, 2019. The value determined by the Stamp Valuation Authority for stamp duty purpose amounted to ₹ 15 lacs. Bala had purchased the flat on 1st January, 2018 at a cost of ₹ 3.50 lacs. Kala sold the flat for ₹ 20 lacs on 30th March, 2020.

Determine the effect of the above transactions on the assessments of Bala and Kala for assessment year 2020-21, assuming that value for stamp duty purpose in case of the second sale was not more than the sale consideration.

Answer

Tax treatment in the hands of the seller, Mr. Bala

Section 50C provides that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

In the instant case, Bala sold the residential flat at Jaipur to his friend Kala for ₹ 10 lacs, whereas the stamp duty value was ₹ 15 lacs. Therefore, stamp duty value shall be deemed to be the full value of consideration for sale of the property. Therefore, short-term capital gain arising to Bala for assessment year 2020-21 will be ₹ 11.50 lacs (i.e. ₹ 15 lacs - ₹ 3.50 lacs).

Tax treatment in the hands of the buyer, Ms. Kala

The taxability provisions under section 56(2)(x), includes within its scope, any immovable property, being land or building or both, received for inadequate consideration by an individual or HUF.

As per section 56(2)(x), where any immovable property is received for a consideration which is less than the stamp duty by an amount exceeding ₹ 50,000, the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the recipient (Individual/HUF) as the income from other sources. The provisions of section 56(2)(x) would be attracted in this case, since the difference exceeds ₹ 50,000. Therefore, ₹ 5 lacs, being the difference between the stamp duty value of the property (i.e., ₹ 15 lacs) and the actual consideration (i.e., ₹ 10 lacs) would be taxable in the hands of Ms. Kala, under the head

'Income from Other Sources'.

As per section 49(4), the cost of acquisition of such property for computing capital gains would be the value which has been taken into account for section 56(2)(x). Accordingly ₹ 15 lacs would be taken as the cost of acquisition of the flat. Therefore, on sale of the flat by Ms. Kala, ₹ 5 lacs (i.e. ₹ 20 lacs – ₹ 15 lacs) would be chargeable to tax as short-term capital gains in her hands for A.Y. 2020-21. Since this is a case covered by section 49(4) and not section 49(1), the period of holding of the previous owner, namely, Bala, will NOT be considered for determining whether the capital gain in short term or long term.

Question 38

Anish owns a residential house which is self-occupied and also a house plot. He sells the house on 28.2.2020 and the house plot on 4.3.2020 for ₹ 18 lacs and ₹ 12 lacs, respectively. The house was purchased on 17.10.2003 for ₹ 4.5 lacs and the plot on 26.12.2002 for ₹ 3 lacs. Anish has purchased a new residential house on 3.5.2020 for ₹ 10 lacs. Compute the income chargeable under the head "Capital Gain" for the A.Y. 2020-21. Cost inflation indices for the financial year 2002-2003, 2003-2004 and 2019-20 are 105, 109 and 289, respectively.

Answer

Computation of Capital Gains of Anish for the A.Y.2020-21

Particulars	₹
Sale of house on 28.2.2020	
Sale consideration received	18,00,000
Less: Indexed cost of acquisition ₹ 4,50,000 x 289/109	11,93,119
Long term capital gain	6,06,881
Less: Exemption under section 54 (lower of capital gains or amount invested)	6,06,881
Taxable capital gain	**Nil**
Sale of house plot on 4.3.2020	
Sale consideration received	12,00,000
Less: Indexed cost of acquisition ₹ 3,00,000 x 289/105	8,25,714
Long term capital gain	3,74,286
Less: Exemption under section 54F	

Investment for the purpose of section 54F is ₹ 3,93,119 (i.e.₹ 10,00,000 – ₹ 6,06,881), which is less than the net consideration on sale of plot. Therefore, only proportionate capital gain would be exempt under section 54F. [Capital gain × Amount invested / Net sale consideration] i.e., [₹ 3,74,286 × ₹ 3,93,119 / ₹ 12,00,000]	
Taxable capital gain	1,22,616

Question 39

Xavier had taken a loan under registered mortgage deed against the house, which was purchased by him on 26.03.2001 for ₹ 5 lacs. The said property was inherited by his son Abraham in financial year 2011-12 as per Will.
For obtaining a clear title thereof, Abraham paid the outstanding amount of loan on 12.02.2012 of ₹ 15 lacs. The said house property was sold by Abraham on 16.03.2020 for ₹ 50 lacs. State with reasons the amount chargeable to capital gains for A.Y. 2020-21
(Cost Inflation Index 2011-12: 184 and 2019-20: 289).

Answer

The cost of inherited property to Mr. Abraham shall be the cost to the previous owner as per provisions of section 49(1)(iiia) and therefore, ₹ 5 lacs, being the cost to his father (amount paid by his father on 26.3.2001 for acquiring the property) shall be the cost to Mr. Abraham, who is the new owner. Payment of outstanding loan of the predecessor by the successor for obtaining a clear title of the property by release of Mortgage Deed shall be the cost of acquisition of the successor under section 48 read with section 55(2) of the Act as held by the Apex Court in case of RM. Arunachalam v. CIT [1997] 227 ITR 222.

Computation of Taxable Capital Gain for the A.Y. 2020-21

Particulars		₹
Sale consideration of house property		50,00,000
Less: **Indexed cost of acquisition (See Note below)**		
(i) Cost to previous owner (₹ 5,00,000 × 289 / 184)	7,85,326	
(ii) Loan amount paid by Mr. Abraham (Benefit of CII is available since the loan amount was paid in the FY 2011-12) (₹ 15,00,000 ×289/184)	23,55,978	31,41,304
Capital gains		**18,58,696**

Note: Since the property was acquired by Mr. Abraham through inheritance, the cost of acquisition will be cost to the previous owner.
As per the definition of indexation cost of acquisition under clause (iii) of Explanation below section 48, indexation benefit will be available only from the previous year in which Abraham first held the asset i.e. P.Y. 2011-12.
However, as per the view expressed by Bombay High Court, in the case of CIT v. Manjula J. Shah (2013) 355 ITR 474, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner.

Question 40

'X', purchased on 18.6.2006, house property for ₹ 22,00,000 which was sold to A on 18.10.2019 for ₹ 38,75,000. The sub-registrar, at the time of registration of sale deed, charged stamp duty on ₹ 60,00,000 which was paid by the buyer.

The Assessing Officer while assessing for capital gain referred the matter to the valuation officer as per the request of vendor. The Valuation Officer determined the value of property at ₹ 55,00,000 on the date of transfer. X seeks your advice on the following:

(i) On what value the Assessing Officer could compute capital gain chargeable to tax?

(ii) The amount of capital gain on which 'X' is required to pay capital gains tax. (The CII for F.Y. 2006-07 is 122 and of F.Y. 2019-20 is 289).

Answer

(i) According to section 50C, the Assessing Officer can refer the property to the valuation officer, only when the following two conditions are satisfied:

(a) The value fixed by the stamp valuation authority is not disputed in appeal or revision etc.

(b) The assessee claims before the Assessing Officer that the value adopted or assessed by the stamp valuation authority exceeds the fair market value (FMV) of the property as on the date of transfer.

In the instant case, though the assessee paid the stamp duty as fixed by the stamp valuation authorities, he had requested the Assessing Officer to refer the property to the Valuation Officer for valuation. The value determined by the Valuation Officer is less than the value adopted by the stamp valuation authority. Therefore, such value only could be adopted for computing chargeable capital gains.

(ii) The amount on which the assessee is required to pay capital gains tax will be as under:-

Sale consideration of the house property under section 50C(1)	₹ 55,00,000
Less: Indexed cost of acquisition ₹ 22,00,000 × 289/122	₹ 52,11,475
Long term capital gain	**₹ 2,88,525**

Question 41

PQR Ltd. is a company in which the whole of its share capital was held by LMN Ltd. Both PQR Ltd. and LMN Ltd. are Indian companies. PQR Ltd. had made investment in shares of Berkley Ltd. in 1993 for ₹ 7,00,000 which it sold to LMN Ltd. on April 1, 2011 for a consideration of ₹ 42,00,000.

The fair market value of these shares of Berkley Ltd., as on April 1, 2001 is ₹ 32,00,000. LMN Ltd. disinvested 7% of the shares held by it in PQR Ltd., in November 2019 by sale to public. It sold the shares in Berkley Ltd. acquired by it from PQR Ltd. in February, 2020 for a sum of ₹ 95,00,000.

Examine the capital gains tax effect of these transactions in the hands of PQR Ltd. and LMN Ltd. in the relevant assessment years, presuming that the shares of Berkley Ltd. are unlisted shares.

The cost inflation index for the F.Y.2011-12 is 184 and F.Y.2019-20 is 289.

Answer

Sale of shares of Berkley Ltd. by PQR Ltd. to LMN Ltd. on 1.4.2011

Since LMN Ltd. is an Indian company which holds 100% of shares of PQR Ltd., the transfer of capital asset, namely, shares of Berkley Ltd., by PQR Ltd. to LMN Ltd. would not be treated as a transfer for attracting capital gains tax liability as per section 47(v).

Hence, no capital gains tax would have been attracted on such transfer in the hands of PQR Ltd.

Disinvestment by LMN Ltd., of 7% shares held in PQR Ltd. in November, 2019

As per section 47A(1), where a holding company ceases to hold 100% of shares of the subsidiary company before the expiry of a period of eight years from the date of transfer of capital asset, the amount of capital gains not charged to tax at the time of transfer would be deemed to be income chargeable under the head "Capital gains" of the previous year in which such transfer took place.

However, in this case, the above deeming provision would not apply because the eight year period from the date of transfer expires on 31.3.2019 and the disinvestment by LMN Ltd. of 7% shares held in PQR Ltd. was only in November, 2019.

Sale of shares of Berkley Ltd. by LMN Ltd. in February 2020

This transaction would attract capital gains tax in the hands of LMN Ltd. for the A.Y.2020-21. The capital gains would be long-term, since the period of holding is more than 24 months.

The cost of acquisition to PQR Ltd. in the year 1993 (i.e., ₹ 7,00,000) or the fair market value as on 1.4.2001 (₹ 32,00,000), whichever is higher, would be deemed as the cost of acquisition in the hands of LMN Ltd.

Computation of capital gains in the hands of LMN Ltd.

Particulars	₹
Sale consideration	95,00,000
Less: Indexed cost of acquisition [₹ 32,00,000 x 289/100]	92,48,000
Long-term capital gains	**2,52,000**
Tax on long-term capital gains@20.8% (₹ 2,52,000 x 20.8%)	52,419

Question 42

Eden Fabs Private Ltd. went into liquidation on 31.07.2019. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

	₹
Share capital (issued on 01.04.2014)	8,00,000
Reserves prior to 31.07.2019	4,00,000
Excess realization in the course of liquidation	6,00,000
Total	**18,00,000**

There are 8 shareholders, each of whom received ₹ 2,25,000 from the liquidator in full settlement. You are required to examine the various issues and advice the shareholders about their liability to Income tax.

Answer

Where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as transfer in the hands of the company for the purpose of section 45.

However, where the shareholder, on liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head "capital gains", in respect of the money so received or the market value of the other assets on the date of distribution as reduced by the amount of dividend deemed under section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

As per section 2(22)(c), dividend includes any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not.

In this case, one-eighth share in the distribution made to a shareholder attributable to the accumulated profits immediately before liquidation would be deemed dividend under section 2(22)(c). The same is exempt under section 10(34) in the hands of the shareholder, since the company, Eden Fabs Pvt. Ltd., is liable to dividend distribution tax in respect of the same.

Therefore, ₹ 2,25,000 minus deemed dividend under section 2(22)(c) would be the full value of consideration in the hands of each shareholder. Against this, the indexed cost of acquisition

computed by applying the relevant CII to the cost of acquisition of ₹ 1,00,000 of each shareholder [i.e., ₹ 8,00,000/8] is to be deducted to arrive at the long-term capital gains. Since the shares are held for more than 24 months, they constitute a long-term capital asset

Since the equity shares are not listed, securities transaction tax would not have been paid and hence, the capital gain (long term) is not exempt under section 112A. The benefit of concessional rate of tax @10% without indexation benefit would also not be available. Hence, such long term capital gain would be taxable @ 20% with indexation benefit.

Therefore, the shareholders have to be advised that capital gains tax liability would arise in their hands, the same should be computed in the manner given above and would be subject to tax@20%.

Question 43

Determine the capital gains/loss on transfer of listed equity shares (STT paid both at the time of acquisition and transfer of shares) and units of equity oriented mutual fund (STT paid at the time of transfer of units) for the A.Y.2020-21 and tax, if any, payable thereon, in the following cases, assuming that these are the only transactions covered under section 112A during the P.Y.2019-20 in respect of these assessees:

(i) Mr. Prasun purchased 300 shares in A Ltd. on 20.5.2017 at a cost of ₹ 400 per share. He sold all the shares of A Ltd. on 31.5.2019 for ₹ 1200. The price at which these shares were traded in National Stock Exchange on 31.1.2018 is as follows –

Particulars	Amount in ₹
Highest Trading Price	700
Average Trading Price	680
Lowest Trading Price	660

(ii) Mr. Raj purchased 200 units each of equity oriented funds, Fund A and Fund B on 1.2.2017 at a cost of ₹ 550 per unit. The units were not listed at the time of purchase. Subsequently, units of Fund A were listed on 1.1.2018 and units of Fund B were listed on 1.2.2018 on the National Stock Exchange. Mr. Raj sold all the units on 3.4.2019 for ₹ 900 each. The details relating to quoted price on National Stock Exchange and net asset value of the units as on 31.1.2018 are given hereunder:

Particulars	Fund A	Fund B
	Amount in ₹	Amount in ₹
Highest Trading Price	750 (on 31.1.2018)	800 (on 1.2.2018)
Average Trading Price	700 (on 31.1.2018)	750 (on 1.2.2018)
Lowest Trading Price	650 (on 31.1.2018)	700 (on 1.2.2018)
Net Asset Value on 31.1.2018	800	950

Answer

For the purpose of computation of long-term capital gains chargeable to tax under section 112A, the cost of acquisition in relation to the long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust acquired before 1st February, 2018 shall be the higher of

(i) cost of acquisition of such asset, i.e., actual cost; and

(ii) lower of

  (a) the fair market value of such asset as on 31.1.2018; and

  (b) the full value of consideration received or accruing as a result of the transfer of the capital asset.

The fair market value of listed equity shares as on 31.1.2018 is the highest price quoted on the

recognized stock exchange as on that date.

Accordingly, long-term capital gain on transfer of STT paid listed equity shares by Mr. Prasun would be determined as follows:

The FMV of shares of A Ltd. would be ₹ 700, being the highest price quoted on National Stock Exchange on 31.1.2018. The cost of acquisition of each equity share in A Ltd. would be ₹ 700, being higher of actual cost i.e., ₹ 400 and ₹ 700 [being the lower of FMV of ₹ 700 as on 31.1.2018 (i.e., the highest trading price) and actual sale consideration of ₹ 1,200]. Thus, the long-term capital gain would be ₹ 1,50,000 i.e., (₹ 1,200 – ₹ 700) x 300 shares. The long-term capital gain of ₹ 50,000 (i.e., the amount in excess of ₹ 1,00,000) would be subject to tax@10% under section 112A, without benefit of indexation.

In the case of units listed on recognised stock exchange on the date of transfer, the FMV as on 31.1.2018 would be the highest trading price on recognised stock exchange as on 31.1.2018 (if shares are listed on that date), else, it would be the net asset value as on 31.1.2018 (where shares are unlisted on that date).

Accordingly, the FMV of units of Fund A as on 31.1.2018 would be ₹ 750 (being the highest trading price on 31.1.2018, since the units of Fund A are listed on that date) and the FMV of units of Fund B as on 31.1.2018 would be ₹ 950 (being the net asset value as on 31.1.2018, since the units of Fund B are unlisted on that date).

The cost of acquisition of a unit of Fund A would be ₹ 750, being higher of actual cost i.e., ₹ 550 and ₹ 750 (being the lower of FMV of ₹ 750 as on 31.1.2018 and actual sale consideration of ₹ 900). Thus, the long-term capital gains on sale of units of Fund A would be ₹ 30,000 (₹ 900 – ₹750) x 200 units.

The cost of acquisition of a unit of Fund B would be ₹ 900, being higher of actual cost i.e., ₹ 550 and ₹ 900 (being the lower of FMV of ₹ 950 as on 31.1.2018 (net asset value) and actual sale consideration of ₹ 900). Thus, the long-term capital gains on sale of units of Fund B would be Nil (₹ 900 – ₹ 900) x 200 units.

Since the long-term capital gains on sale of units is ₹ 30,000, which is less than ₹ 1,00,000, the said sum is not chargeable to tax under section 112A.

CHAPTER - 8
Income from Other Sources

Section A – ICAI Study Material Questions

Question 1

A Ltd., a domestic company, declared dividend of ₹ 170 lakh for the year F.Y.2018-19 and distributed the same on 10.7.2019. Mr. X, holding 10% shares in A Ltd., receives dividend of ₹ 17 lakh in July, 2019. Mr. Y, holding 5% shares in A Ltd., receives dividend of ₹ 8.50 lakh. Discuss the tax implications in the hands of A Ltd., Mr. X and Mr. Y, assuming that Mr. X and Mr. Y have not received dividend from any other domestic company during the year.

Answer

(i) The dividend of ₹ 170 lakh declared and distributed in the P.Y.2019-20 is subject to dividend distribution tax under section 115-O in the hands of A Ltd. First of all, the dividend received has to be grossed up by applying the rate of 15%. The gross dividend is ₹ 200 lakhs [₹ 170 lakhs x 100/85]. Dividend distribution tax @17.472% is ₹ 34.944 lakhs.

(ii) In the hands of Mr. X, dividend received upto ₹ 10 lakh would be exempt under section 10(34). ₹ 7 lakh, being dividend received in excess of ₹ 10 lakh, would be taxable @10% as per section 115BBDA. Such dividend would not be exempt under section 10(34).

Therefore, tax payable by Mr. X on dividend of ₹ 7 lakh under section 115BBDA would be ₹ 72,800 [i.e., 10% of ₹ 7 lakh + health and education cess @4%].

(iii) In the hands of Mr. Y, the entire dividend of ₹ 8.50 lakh received would be exempt under section 10(34), since only dividend received in excess of ₹ 10 lakh would be taxable under section 115BBDA.

Question 2

Dhaval is in business of manufacturing customized kitchen equipments. He is also the Managing Director and held nearly 65% of the paid-up share capital of Aarav (P) Ltd. A substantial part of the business of Dhaval is obtained through Aarav (P) Ltd. For this purpose, Aarav (P) Ltd. passed on the advance received from its customers to Dhaval to execute the job work entrusted to him.
The Assessing Officer held that the advance money received by Dhaval is in the nature of loan given by Aarav (P) Ltd. to him and accordingly is deemed dividend within the meaning of provisions of section 2(22)(e) of the Income-tax Act, 1961. The Assessing Officer, therefore made the addition by treating advance money as deemed dividend.
Examine whether the action of the Assessing Officer is tenable in law.

Answer

As per section 2(22)(e), in case a company, not being a company in which the public are substantially interested, makes payment of any sum by way of advance or loan to a shareholder holding not less than 10% of voting power/share capital of the company, then, the payment so made shall be deemed to be dividend in the hands of such shareholder to the extent to which the company possesses accumulated profits.

In the present case, Dhaval is holding 65% of the paid-up capital of Aarav (P) Ltd. Aarav (P) Ltd. has passed on advance received from its customers to Dhaval for execution of job work entrusted to Dhaval.

Since Aarav (P) Ltd. is not a company in which public are substantially interested, the applicability of

the provisions of section 2(22)(e) in respect of such transaction has to be examined. In CIT v. Rajkumar (2009) 318 ITR 462 (Del.), it was held that trade advance given to the shareholder which is in the nature of money transacted to give effect to a commercial transaction, would not amount to deemed dividend under section 2(22)(e). The Delhi High Court ruling in CIT v. Ambassador Travels (P) Ltd. (2009) 318 ITR 376 also supports the above view.

In the present case, the payment is made to Dhaval by Aarav (P) Ltd. for execution of work is in the course of commercial business transaction and therefore, it cannot be treated as deemed dividend under section 2(22)(e). Hence, the action of the Assessing Officer is not tenable in law.

Note – This can also be answered on the basis of Circular No. 19/2017, dated 12.06.2017. The CBDT has, in its circular clarified that it is a settled position that trade advances, which are in the nature of commercial transactions, would not fall within the ambit of the word 'advance' in section 2(22)(e) and therefore, the same would not to be treated as deemed dividend. Since, the payment is made to Dhaval by Aarav (P) Ltd. for execution of work is in the course of commercial business transaction and therefore, the advance cannot be treated as deemed dividend under section 2(22)(e). Hence, the action of the Assessing Officer is not tenable in law.

Question 3

MNO (P) Ltd. is a company in which the public are not substantially interested. K is a shareholder of the company holding 15% of the equity shares. The accumulated profits of the company as on 1.10.2019 amounted to ₹ 10,00,000. The company lent ₹ 1,00,000 to K by an account payee bank draft on 1.10.2019. The loan was not connected with the business of the company. K repaid the loan to the company by an account payee bank draft on 30.3.2020. Examine the effect of the borrowal and repayment of the loan by K on the computation of his total income for the assessment year 2020-21.

Answer

As per section 2(22)(e), any payment by a company, in which the public are not substantially interested, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power, shall be treated as dividend to the extent to which the company possesses accumulated profits.

In the instant case, MNO (P) Ltd. is a company in which the public are not substantially interested. The company has accumulated profits of ₹ 10,00,000 on 1.10.2019. The loan given by the company to K was not in the course of its business. K holds more than 10% of the equity shares in the company. Therefore, assuming that K has voting power equivalent to his shareholding, section 2(22)(e) comes into play and MNO (P) Ltd. has to pay dividend distribution tax under section 115- O @ 34.944% (30% plus surcharge @12% plus health and education cess @4%) on ₹ 1,00,000, representing the amount lent by the company to K. Deemed dividend of ₹ 1,00,000 under section 2(22)(e) would be exempt under section 10(34) in the hands of Mr. K.

Under section 2(22)(e), the liability arises the moment the loan is borrowed by the shareholder and it is immaterial whether the loan is repaid before the end of the accounting year or not. Therefore, the repayment of loan by K to the company on 30.3.2020 will not affect the taxability of the sum of ₹ 1,00,000 as deemed dividend.

Question 4

Mr. A, a dealer in shares, received the following without consideration during the P.Y.2019-20 from his friend Mr. B, -

(1) Cash gift of ₹ 75,000 on his anniversary, 15th April, 2019.

(2) Bullion, the fair market value of which was ₹ 60,000, on his birthday, 19th June, 2019.
(3) A plot of land at Faridabad on 1st July, 2019, the stamp value of which is ₹ 5 lakh on that date. Mr. B had purchased the land in April, 2009.

Mr. A purchased from his friend Mr. C, who is also a dealer in shares, 1000 shares of X Ltd. @ ₹ 400 each on 19th June, 2019, the fair market value of which was ₹ 600 each on that date. Mr. A sold these shares in the course of his business on 23rd June, 2019.

Further, on 1st November, 2019, Mr. A took possession of property (building) booked by him two years back at ₹ 20 lakh. The stamp duty value of the property as on 1st November, 2019 was ₹ 32 lakh and on the date of booking was ₹ 23 lakh. He had paid ₹ 1 lakh by account payee cheque as down payment on the date of booking.

On 1st March, 2020, he sold the plot of land at Faridabad for ₹ 7 lakh.

Compute the income of Mr. A chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2020-21.

Answer

Computation of "Income from other sources" of Mr. A for the A.Y.2020-21

	Particulars	**Rs.**
1	Cash gift is taxable under section 56(2)(x), since it exceeds ₹ 50,000	**75,000**
2	Since bullion is included in the definition of property, therefore, when bullion is received without consideration, the same is taxable, since the aggregate fair market value exceeds ₹ 50,000	**60,000**
3	Stamp value of plot of land at Faridabad, received without consideration, is taxable under section 56(2)(x)	**5,00,000**
4	Difference of ₹ 2 lakh in the value of shares of X Ltd. purchased from Mr. C, a dealer in shares, is not taxable as it represents the stock-in-trade of Mr. A. Since Mr. A is a dealer in shares and it has been mentioned that the shares were subsequently sold in the course of his business, such shares represent the stock-in-trade of Mr. A.	**-**
5	Difference between the stamp duty value of ₹ 23 lakh on the date of booking and the actual consideration of ₹ 20 lakh paid is taxable under section 56(2)(x) since the difference exceeds ₹ 1 lakh being, the higher of ₹ 50,000 and 5% of consideration	**3,00,000**
	Income from Other Sources	**9,35,000**

Computation of "Capital Gains" of Mr. A for the A.Y.2020-21

Particulars	**₹**
Sale Consideration	7,00,000
Less: Cost of acquisition [deemed to be the stamp value charged to tax under section 56(2)(x) as per section 49(4)]	5,00,000
Short-term capital gains	**2,00,000**

Note – The resultant capital gains will be short-term capital gains since for calculating the period of holding, the period of holding of previous owner is not to be considered.

Question 5

Discuss the taxability or otherwise of the following in the hands of the recipient under section 56(2)(x) of the Income-tax Act, 1961 -

(i) Akhil HUF received ₹ 75,000 in cash from niece of Akhil (i.e., daughter of Akhil's sister). Akhil is the Karta of the HUF.

(ii) Nitisha, a member of her father's HUF, transferred a house property to the HUF without consideration. The stamp duty value of the house property is ₹ 9,00,000.

(iii) Mr. Akshat received 100 shares of A Ltd. from his friend as a gift on occasion of his 25th marriage anniversary. The fair market value on that date was ₹ 100 per share. He also received jewellery worth ₹ 45,000 (FMV) from his nephew on the same day.

(iv) Kishan HUF gifted a car to son of Karta for achieving good marks in XII board examination. The fair market value of the car is ₹ 5,25,000.

Answer

	Taxable/ Non-taxable	**Amount liable to tax (₹)**	**Reason**
(i)	Taxable	75,000	Sum of money exceeding ₹ 50,000 received without consideration from a non-relative is taxable under section 56(2)(x). Daughter of Mr. Akhil's sister is not a relative of Akhil HUF, since she is not a member of Akhil HUF.
(ii)	Non-taxable	Nil	Immovable property received without consideration by a HUF from its relative is not taxable under section 56(2)(x). Since Nitisha is a member of the HUF, she is a relative of the HUF. However, income from such asset would be included in the hands of Nitisha under 64(2).
(iii)	Taxable	55,000	As per provisions of section 56(2)(x), in case the aggregate fair market value of property, other than immovable property, received without consideration exceeds ₹50,000, the whole of the aggregate value shall be taxable. In this case, the aggregate fair market value of shares (₹ 10,000) and jewellery (₹ 45,000) exceeds ₹ 50,000. Hence, the entire amount of ₹ 55,000 shall be taxable.
(iv)	Non-taxable	Nil	Car is not included in the definition of property for the purpose of section 56(2)(x), therefore, the same shall not be taxable.

Question 6

Mr. Hari, a property dealer, sold a building in the course of his business to his friend Mr. Rajesh, who is a dealer in automobile spare parts, for ₹ 90 lakh on 1.1.2020, when the stamp duty value was ₹ 150 lakh. The agreement was, however, entered into on 1.9.2019 when the stamp duty value was ₹ 140 lakh. Mr. Hari had received a down payment of ₹ 15 lakh by a crossed cheque from Mr. Rajesh on the date of agreement. Discuss the tax implications in the hands of Mr. Hari and Mr. Rajesh, assuming that Mr. Hari has purchased the building for ₹ 75 lakh on 12th July, 2018.

Would your answer be different if Hari was a share broker instead of a property dealer?

Answer

Case 1: Tax implications if Mr. Hari is a property dealer

In the hands of Mr. Hari	**In the hands of Mr. Rajesh**

In the hands of Hari, the provisions of section 43CA would be attracted, since the building represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value and the stamp duty value exceeds 105% of consideration. Under section 43CA, the option to adopt the stamp duty value on the date of agreement can be exercised only if whole or part of the consideration has been received on or before the date of agreement by way of account payee cheque or draft or by use of ECS through a bank account or through such other prescribed electronic mode on or before the date of agreement. In this case, since the down payment of ₹ 15 lakhs is received on the date of agreement by crossed cheque and not account payee cheque, the option cannot be exercised. Therefore, **₹ 75 lakh**, being the difference between the stamp duty value on the date of transfer (i.e., ₹ 150 lakh) and the purchase price (i.e., ₹ 75 lakh), would be chargeable as **business income** in the hands of Mr. Hari, since stamp duty value exceeds 105% of the consideration.	Since Mr. Rajesh is a dealer in automobile spare parts, the building purchased would be a capital asset in his hands. The provisions of section 56(2)(x) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration and the difference between the consideration and stamp duty value exceeds ₹ 4,50,000, being the higher of ₹ 50,000 and 5% of consideration. Therefore, **₹ 60 lakh,** being the difference between the stamp duty value of the property on the date of registration (i.e., ₹ 150 lakh) and the actual consideration (i.e., ₹ 90 lakh) would be taxable **under section 56(2)(x)** in the hands of Mr. Rajesh, since the payment on the date of agreement is made by crossed cheque and not account payee cheque/draft or ECS or through such other prescribed electronic mode.

Case 2: Tax implications if Mr. Hari is a stock broker

In the hands of Mr. Hari	In the hands of Mr. Rajesh
In case Mr. Hari is a stock broker and not a property dealer, the building would represent his capital asset and not stock-in-trade. In such a case, the provisions of section 50C would be attracted in the hands of Mr. Hari since building is transferred for a consideration less than the stamp duty value; and the stamp duty value exceeds 105% of consideration. Thus, **₹ 75 lakh, being the difference between the stamp duty value on the date of registration (i.e., ₹ 150 lakh) and the purchase price (i.e., ₹ 75 lakh) would be chargeable as short-term capital gains.** It may be noted that under section 50C, the option to adopt the stamp duty value on the date of agreement can be exercised only if whole or part of the consideration has been received on or before the date of agreement by way of account payee cheque or draft or by use of ECS through a bank account or through such other prescribed electronic mode on or before the date of agreement. In this case, since the down payment of ₹15 lakhs has been received on the date of agreement by crossed cheque and not account payee cheque, the option cannot be exercised.	There would be no difference in the taxability in the hands of Mr. Rajesh, whether Mr. Hari is a property dealer or a stock broker. Therefore, the provisions of section 56(2)(x) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration and the difference between the consideration and stamp duty value exceeds ₹ 4,50,000, being the higher of ₹ 50,000 and 5% of consideration. Therefore, **₹ 60 lakh,** being the difference between the stamp duty value of the property on the date of registration (i.e., ₹ 150 lakh) and the actual consideration (i.e., ₹ 90 lakh) would be taxable under section 56(2)(x) in the hands of Mr. Rajesh since the payment on the date of agreement is made by crossed cheque and not account payee cheque/draft or ECS or through such other prescribed electronic mode.

Question 7

Interest on enhanced compensation received by Mr. G during the previous year 2019-20 is ₹ 5,00,000. Out of this interest, ₹ 1,50,000 relates to the previous year 2016-17, ₹ 1,65,000 relates to previous year 2017-18 and ₹ 1,85,000 relates to previous year 2018-19. Discuss the tax implication, if any, of such interest income for A.Y.2020-21.

Answer

The entire interest of ₹ 5,00,000 would be taxable in the year of receipt, namely, P.Y.2019-20.

Particulars	₹
Interest on enhanced compensation taxable u/s 56(2)(viii)	5,00,000
Less: Deduction under section 57(iv) @50%	2,50,000
Interest chargeable under the head "Income from other sources"	**2,50,000**

Question 8

Parimal, Managing Director of Heavens Engg. Pvt. Ltd. holds 70% of its paid up capital of ₹ 20 Lacs. The balance as at 31.03.2019 in General Reserve was ₹ 6 Lacs. The company on 1.04.2019 gave an interest-free loan of ₹ 5 lacs to its Supervisor having salary of ₹ 4,000 p.m., who in turn on 15.4.2019 advanced the said amount of loan so taken from the company to Shri Parimal. The Assessing Officer had treated the amount of advance as deemed dividend. Is the action of Assessing Officer correct?

Answer

The company had advanced a loan to an employee who in turn had advanced the same to the Managing Director of the company holding 70% of its capital. By virtue of the provisions of section 2(22)(e), the same shall be treated as the payment by a company in which public are not substantially interested, on behalf of, or for individual benefit of any such share holder (who holds not less than 10% of the voting power), to the extent to which the company possesses accumulated profits.

In this case, the company has reserves of ₹ 6 Lacs on 31st March of the preceding year and the amount of loan advanced on 1st April is ₹ 5 Lacs. Therefore, the payment is to be treated as deemed dividend. The amount of interest-free loan of ₹ 5 Lacs given by the company to the supervisor who in turn had given the same to Mr. Parimal, shall be construed as the amount given for the benefit of Mr. Parimal and would be treated as deemed dividend. On such amount the Heavens Engg. Pvt. Ltd. is liable to pay dividend distribution tax @30% plus surcharge @12% plus Health and education cess @4%. This has been held by the Supreme Court in the case of L. Alagusundaram Chettiar v. CIT (2001) 252 ITR 893.

Question 9

Mr. Santhanam holding 25% voting power in VKS Manufacturing Private Limited permitted his own land to be mortgaged to a bank for enabling the company to obtain a loan. Mr. Santhanam requested the company to release the property from the mortgage. The company failed to do so, but for retaining the benefit of bank loan it gave an advance of ₹ 10 lakhs to Mr. Santhanam, which was authorized by a resolution passed by the Board of Directors. The company's accumulated profit on the date of payment of advance was ₹ 50 lakhs. The Assessing Officer proposes to treat the amount of ₹ 10 lakhs as deemed dividend by invoking the provision of section 2(22)(e).

Is the proposition of the Assessing Officer correct in law?

Answer

The issue under consideration is whether loan or advance given to a shareholder by the company, in return of an advantage or benefit conferred on the company by the shareholder, can be deemed as dividend under section 2(22)(e) of the Income-tax Act, 1961 in the hands of the shareholder

The facts of the case are similar to the facts in Pradip Kumar Malhotra v. CIT (2011) 338 ITR 538, wherein the above issue came up before the Calcutta High Court.

The High Court observed that the phrase "by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans which a shareholder enjoys simply on account of being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power.

In case such loan or advance is given to such shareholder as a consequence of any further consideration received from such a shareholder which is beneficial to the company, such advance or loan cannot be a deemed dividend within the meaning of the Act.

Thus, gratuitous loan or advance given by a company to a shareholder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) to the extent of accumulated profits of the company but not the cases where the loan or advance is given in return for an advantage conferred upon the company by such shareholder.

In this case, advance of ₹ 10 lakhs was given by VKS Manufacturing (P) Ltd. to Mr. Santhanam holding 25% of voting power in lieu of non-release of his personal property from mortgage thereby enabling the company to retain the benefit of loan obtained from bank. Therefore, applying the rationale of the Calcutta High Court ruling in Pradip Kumar Malhotra's case, such advance cannot be brought within the purview of section 2(22)(e), since it was not in the nature of gratuitous advance but was given to protect the interest of the company.

The proposition of the Assessing Officer to treat the amount of ₹ 10 lakhs as deemed dividend by invoking the provisions of section 2(22)(e) in this case is, therefore, **not correct**.

Question 10

An enterprise engaged in manufacturing of steel balls discontinued its activities and decided to lease out its factory building, plant and machinery and furniture from 1.4.2019 on a consolidated lease rent of ₹ 50,000 per month. Compute the income for Assessment Year 2020-21 of the assessee from following information

		₹
(i)	Interest received on deposits	1,00,000
(ii)	Brokerage paid on hundi loan taken	2,000
(iii)	Interest paid on hundi and other loans which were given as deposits on interest to others	75,000
(iv)	Expenses incurred on repairs of building, plant and machinery	15,000
(v)	Fire insurance premium of plant and machinery and furniture	12,000
(vi)	Depreciation for the year	1,47,500
(vii)	Legal fees paid to an advocate for drafting and registering the lease agreement	1,500

(viii) Factory licence fees paid for the year 1,000

(ix) There is unabsorbed depreciation of ₹ 2,75,000 of the Assessment Years 2018-19 and 2019-20.

(x) Interest paid in (iii) above includes an amount of ₹ 25,000 remitted to a non-resident outside India on which tax was not deducted at source.

Answer

The income derived from leased assets shall be chargeable to tax as 'Income from other sources' under section 56(2)(iii) but the computation thereof shall be made after allowing deductions specified under sections 30, 31 and 32 subject to section 38. This is as per the provisions of section 57(ii) and 57(iii).

Computation of income under the head "Income from other sources"

Particulars		₹	₹
(A) Lease Rent for 12 months @ ₹ 50,000 p.m.			6,00,000
Less: Expenses and deductions allowable under section 57(ii) & 57(iii):			
Repairs		15,000	
Fire Insurance Premium		12,000	
Legal expenses for drafting of lease agreement		1,500	
Factory Licence fee		1,000	
Depreciation for the year		1,47,500	
Unabsorbed depreciation of earlier assessment years – eligible for deduction **(Note 1)**		2,75,000	4,52,000
			1,48,000
(B) Interest on Deposits		1,00,000	
Less: Expenses allowable under section 57(i) Brokerage	₹ 2,000		
Interest on hundi loans **(Note 2)**	₹ 50,000	52,000	48,000
Total Income			**1,96,000**

Notes:

1. Unabsorbed depreciation of ₹ 2,75,000 pertains to earlier assessment years. The unabsorbed depreciation shall form part of the current year depreciation and can be set off against any other head of income. Accordingly, the amount of ₹ 2,75,000 is adjustable/ allowed to be set off against 'Income from other sources'.
2. Since deposits are made by investing amount received on hundi and other loans, the interest on hundi and other loans would be eligible for deduction from the income arising on such deposits.

   However, interest paid to non-resident is not eligible for deduction as the tax has not been deducted at source.

Question 11

In July 2019, Mr. Pervez employed as Marketing Manager in a Pharma company, received a Maruti car as gift from a distributor of the company. The value of the gifted car is estimated at ₹ 2,60,000. Is the value of car taxable as income? If so, under what head it is taxable?

Answer

Mr. Pervez, an employee of a Pharma company, has received a car as a gift from a distributor of the company. Since there is no employer-employee relationship in this case between the distributor and Mr. Pervez, the value of gift is **not** a perquisite chargeable to tax under the head "Salaries".

Section 56(2)(x), brings within its scope the value of any property received by any person. For this purpose, "property" means immovable property being land or building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or bullion.

Therefore, for the purpose of attracting the provisions of section 56(2)(x) for chargeability under the head "Income from Other Sources", an individual should be in receipt of property as defined therein. Since, car is not included in the definition of "property", the provisions of section 56(2)(x) would not be attracted in the hands of Mr. Pervez.

Section B – Additional Questions

Question 12

M, an individual, is 70 years of age. He is a sitting member of the State Assembly of Karnataka and for the financial year 2019-20 received the following amounts from the Assembly Secretariat:

(i)	Basic pay	₹16,000 p.m.
(ii)	Constituency allowance	₹8,000 p.m.
(iii)	Telephone allowance	₹4,000 p.m.
(iv)	Electricity allowance	₹3,000 p.m. [from June, 2019 onwards]

He owns a house in Delhi which has been let out at ₹ 15,000 p.m. He received rent for 10 months only, the house having remained vacant for two months. Municipal taxes of ₹ 12,000 were paid by the tenant. Interest of ₹ 50,000 was paid by M on the amount borrowed by him to buy the house.

Compute his total income for the assessment year 2020-21.

Answer

Computation of total income of Mr. M for A.Y. 2020-21

Particulars		₹	₹
Income from house property			
Gross Annual Value (GAV) **[See Note 1**		1,50,000	
Municipal taxes (not allowed since it is borne by tenant)		-	
Net annual value (NAV)		1,50,000	
***Less*: Deduction under section 24**			
(a) 30% of NAV	₹45,000		
(b) Interest on borrowed capital	₹50,000	95,000	
Income from Other Sources [See Note 2 below]			
Basic Pay (₹ 16,000 x 12)		1,92,000	
Constituency allowance (₹ 8,000 x 12)	₹96,000		
Less: Exempt under section 10(17)	₹96,000	-	
Electricity allowance (₹ 3,000 x 10)		30,000	
Telephone allowance (₹ 4,000 x 12)		48,000	
Total Income			**3,25,000**

Notes:

(1) In the absence of other information, rent received has been taken as the Gross Annual Value.

(2) The pay and allowances of a member of the State Assembly would be taxable under the head "Income from other sources", since there is no employer-employee relationship in this case.

Question 13

Mrs. Harini Rao received the following gifts during the previous year 2019-20:

(i) Gift of ₹ 1,50,000 on 15.5.2019 from her close friend.

(ii) Gift of jewellery worth ₹ 3,00,000 on 1.8.2019 from her fiancée.

(iii) Gifts of ₹ 51,000 each received from her two friends on the occasion of her marriage on 30.10.2019.

(iv) Gift of ₹ 51,000 on 1.12.2019 from her father's sister.

(v) Gift of ₹ 21,000 from her husband's friend on 1.1.2020.
(vi) Gift of ₹ 25,000 on 12.1.2020 from her family friend.
(vii) Gift of ₹ 11,000 on 12.2.2020 from her brother's mother-in-law.
(viii) Gift of ₹ 75,000 from her sister-in-law.
Compute her gross total income for the assessment year 2020-21.

Answer

Computation of Gross Total Income of Mrs. Harini Rao for the A.Y. 2020-21

Particulars		₹	₹
Income from other sources			
(i)	Cash Gift from close friend is taxable	1,50,000	
(ii)	Gift of jewellery is taxable ["Jewellery" is included in the definition of property as per *Explanation* to section 56(2)(x) and the fair market value exceeds ₹ 50,000]	3,00,000	
(iii)	Gifts received from her two friends are exempt as they have been received on the occasion of her marriage	-	
(iv)	Gift from her father's sister is exempt as the donor is covered in the definition of relative	-	
(vi)	Gift from her husband's friend is taxable	21,000	
(vii)	Gift from her family friend is taxable	25,000	
(viii)	Gift from her brother's mother-in-law is taxable as the donor is not covered in the definition of relative	11,000	
(ix)	Gift from her sister-in-law (husband's sister) is exempt as the donor is covered in the definition of relative	-	
			5,07,000
Gross Total Income			**5,07,000**

Question 14

Mr. Ganesh received the following gifts during the P.Y.2019-20 from his friend Mr. Sundar, -
(1) Cash gift of ₹ 51,000 on his birthday, 19th June, 2019.
(2) 50 shares of Beta Ltd., the fair market value of which was ₹ 60,000, on his birthday, 19th June, 2019.
(3) 100 shares of Alpha Ltd., the fair market value of which was ₹ 70,000 on the date of transfer. This gift was received on the occasion of Diwali. Mr. Sundar had originally purchased the shares on 10.8.2019 at a cost of ₹ 50,000.

Further, on 20th November, 2019, Mr. Ganesh purchased land from his sister's mother-in-law for ₹ 5,00,000. The stamp value of land was ₹ 7,00,000.
On 15th February, 2020, he sold the 100 shares of Alpha Ltd. for ₹ 1 Lac.
Compute the income of Mr. Ganesh chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2020-21.

Answer

Computation of "Income from other sources" of Mr. Ganesh for the A.Y.2020-21

	Particulars	₹
(1)	Cash gift received on 19.06.2019 is taxable under section 56(2)(x)	51,000
(2)	Value of shares of Beta Ltd. gifted by Mr. Sundar on 19th June, 2019 is taxable as "shares" are included within the definition of "property"	60,000

(3)	Fair market value of shares of Alpha Ltd. is taxable	70,000
(4)	Purchase of land for inadequate consideration on 20.11.2019 would attract the provisions of section 56(2)(x), if the difference between stamp duty value and actual consideration exceeds ₹ 50,000. Since the difference between Stamp Duty Value and Consideration is ₹ 2,00,000 (i.e., ₹ 7,00,000 - ₹ 5,00,000), **it is chargeable to tax.** Sister"s Mother-in-law is not a relative within the meaning of section 56(2)(x).	2,00,000
Income from Other Sources		**3,81,000**

Computation of "Capital Gains" of Mr. Ganesh for the A.Y.2020-21	
Particulars	**₹**
Sale Consideration (15.02.2020)	1,00,000
Less: Cost of acquisition [deemed to be the fair market value charged to tax under section 56(2)(x)]	70,000
Short-term capital gains	**30,000**

Question 15

Discuss the applicability of the provisions of section 56(2)(viib) in respect of the shares issued by the following closely held companies to resident Indians –

Company	Consideration received for issue of a share (₹)	Face value of a share (₹)	Fair Market Value (FMV) of a share (₹)	Number of shares issued
Win (P) Ltd.	370	300	350	1,00,000
Gain (P) Ltd.	330	300	350	2,00,000
Profit (P) Ltd.	290	300	280	3,00,000
Top (P) Ltd.	310	300	275	4,00,000

Answer

Applicability of the provisions of section 56(2)(viib)

Co.	Face value of shares (₹)	FMV of shares (₹)	Consideration received (₹)	Applicability of section 56(2)(viib)
Win (P) Ltd.	300	350	370	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium (i.e., issue price exceeds the face value of shares). The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib).i.e., ₹ 20 lakh, being ₹ 20 (₹ 370 - ₹ 350) per share × 1,00,000 shares, shall be treated as income in the hands of Win (P) Ltd.
Gain (P) Ltd.	300	350	330	The provisions of section 56(2)(viib) are attracted since the shares are issued at a premium. However, no sum shall be chargeable to tax under the said section in the hands of Gain

				(P) Ltd. as the shares are issued at a price less than the FMV of shares.
Profit (P) Ltd.	300	280	290	Section 56(2)(viib) is not attracted since the shares are issued at a discount, though the issue price is greater than the FMV.
Top (P) Ltd.	300	275	310	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium. The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib). Therefore, ₹ 140 lakh, being ₹ 35 (₹ 310 - ₹ 275) per share × 4,00,000 shares, shall be treated as income in the hands of Top (P) Ltd.

Question 16

Mr. X received the following gifts / amounts during the previous year 2019-20:

(i) Gift of bullion worth ₹ 60,000 on his birthday from his friend.

(ii) Received a car from cousin on payment of ₹ 1 lac, fair market value of which was ₹ 4 lacs.

(iii) Received cash gift of ₹ 18,000 each from three of his friends A, B & C on 24-09-2019.

(iv) Acquired an office building on 22-11-2019 from his friend Q for a consideration of ₹ 10 lacs, stamp value of which is ₹ 20 lacs.

(v) In respect of land of Mr. X acquired by Railways in the year 2013, he received the following amount on 25-12-2019 as interest on enhanced compensation on the order of the court –

Relating to previous year	₹
2013-14	1,45,000
2014-15	1,75,000
2015-16	1,10,000

You are required to compute the income of Mr. X chargeable under the head "Income from other sources" for the Assessment Year 2020-21, assuming that he has no other income.

Answer

Computation of "Income from other sources" of Mr. X for the A.Y.2020-21

	Particulars	₹
(i)	Since bullion is included in the definition of "property", therefore, when bullion is received without consideration, the same is taxable under section 56(2)(x), as the aggregate fair market value of bullion exceeds ₹ 50,000	60,000
(ii)	Since car is not included in the definition of property, therefore the difference of ₹ 3 lakh between fair market value and purchase price of car is **not** taxable under section 56(2)(x)	Nil
(iii)	Cash gift received from friends is taxable under section 56(2)(x), since its aggregate value exceeds ₹ 50,000 (₹ 18,000 × 3)	54,000
(iv)	Immovable property purchased for inadequate consideration is taxable under section 56(2)(x). Therefore the difference of ₹ 10 lakh between stamp duty value and purchase price of building **is taxable** u/s 56(2)(x).	10,00,000

(v)	As per section 145A, interest received during the year on enhanced compensation shall be deemed to be the income of the year in which such interest is received, irrespective of the method of accounting followed by the assessee. Hence, the interest received by Mr. X, is taxable u/s 56(2)(viii) in the previous year 2018-19.	
	(₹1,45,000 + ₹1,75,000 + ₹1,10,000) ₹4,30,000	
	Less: Deduction under section 57 @50% of ₹4,30,000 ₹2,15,000	2,15,000
Income from Other Sources		**13,29,000**

Question 17

From the following particulars, compute the gross total income of Mr. Z for the assessment year 2020-21:

(i) Mr. Y transferred his residential house to Mr. Z for ₹ 10 lakh on 1.4.2019. The value of the said house as per stamp valuation authority was ₹ 18 lakhs. Mr. Z is a childhood friend of Mr. Y.

(ii) Mr. Z received a car from his cousin on payment of ₹ 2,50,000, fair market value of which was ₹4,00,000.

(iii) Land of Mr. Z was acquired by railways in 2013. On 15/12/2019, he received ₹1,70,000 as interest on enhanced compensation on the order of court.

(iv) On a fixed deposit of ₹ 10 lakhs, in a bank, Mr. Z received an interest of ₹ 90,000. He had also borrowed ₹ 50 lakhs from the same bank, on security of the fixed deposit and was liable to pay ₹ 50,000 by way of interest to the bank. He, therefore, offered the difference between the two amounts i.e. ₹40,000 as "Income from Other Sources".

Answer

Computation of gross total income of Mr. Z for the A.Y.2020-21

Particulars		₹
Income from Other Sources		
(i)	Receipt of immovable property for inadequate consideration attracts the provisions of section 56(2)(x). The difference between the stamp duty value (₹ 18 lakhs) and the actual consideration (₹ 10 lakhs) would be taxable.	8,00,000
(ii)	Since car is not included in the definition of "property" under section 56(2)(x), receipt of car for inadequate consideration would not attract the provisions of section 56(2)(x).	-
(iii)	Interest on enhanced compensation amounting to ₹ 1,70,000 would be taxable under section 56(2)(viii) in the year of receipt. Deduction@50% is allowable under section 57(iv). Hence, the taxable interest is ₹ 85,000 (i.e., ₹ 1,70,000 – ₹ 85,000)	85,000
(iv)	Interest of ₹ 90,000 received on fixed deposit is income of Mr. Z. The interest of ₹ 50,000 on loan taken by Mr. Z from the same bank on security of the fixed deposit will not go to reduce the income by way of interest on fixed deposit [CIT v. D. V. Gopinathan (2001) 248 ITR 449].	90,000
Gross Total Income		**9,75,000**

Question 18

The land owned by Ganesh was acquired by NHAI in the year 2012 and since then the litigation was going on for enhancement of compensation. The issue was resolved on

11.09.2019 and the court ordered finally to make payment to Ganesh of the enhanced compensation and the following amounts for interest on such enhanced compensation:

Financial Year	Amount (₹)
2016-2017	1,15,000
2017-2018	2,25,500
2018-2019	3,75,000
2019-2020	2,14,500

Explain the provisions of the Act and also work out the amount of interest and the assessment year in which the same shall be taxed.

Answer

Clause (b) of section 145A provides that the interest received by an assessee on compensation or on enhanced compensation shall be deemed to be the income for the year in which it is received, irrespective of the method of accounting followed by the assessee.
Clause (viii) inserted in section 56(2) provides that income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A shall be assessed as "Income from other sources" in the year in which it is received.
Clause (iv) inserted in section 57 allows a deduction of 50% of such income. It is fur ther clarified that no other deduction would be allowable under any other clause of section 57 in respect of such income.
Therefore, the entire interest income of ₹ 9,30,000 received by Ganesh for the different years would be taxable under the head "Income from other sources" in the year of receipt i.e., P.Y.2018-19 (A.Y. 2020-21) :-

Particulars	₹
Interest on enhanced compensation taxable under section 56(2)(viii)	9,30,000
Less: Deduction under section 57(iv) @ 50%	4,65,000
Interest chargeable under the head "Income from other sources"	**4,65,000**

Question 19

Discuss the taxability or otherwise of the following transactions:

(i) Mr. A purchased 10 acres of agricultural land from Mr. B at the rate of ₹ 2 lakh per acre on 10-05-2019. The guideline value of the land on the date of the transaction was ₹ 3 lakhs per acre. However, he had entered into an agreement for purchase of the land on 10-03-2019 when the guideline value was ₹ 2.20 lakhs per acre. He had paid a token advance of ₹ 1 lakh by account payee cheque.

(ii) Mr. A received cash gift of ₹ 4.75 lakhs from B on the occasion of his 61st birthday which was celebrated like marriage as per tradition, and ₹ 25,000 from C. Both B and C are his distant relatives.

(iii) Mr. Dileep contributed ₹ 2 lakhs to a Trust created for the purpose of marriage of his friend's daughter.

Note: (Guideline value means Assessable stamp duty value)

Answer

(i) Agricultural land is not a capital asset and hence, there would be no tax implications in the hands of the seller, Mr. B.

In the hands of the buyer, Mr. A, the provisions of section 56(2)(x) would be attracted where any property is received without consideration or for inadequate consideration.

"Property" means a **capital asset**, namely, immovable property being land or building or both. In this case, since agricultural land is **not** a capital asset, it would not fall within the definition of property to attract the provisions of section 56(2)(x). Therefore, the provisions of section 56(2)(x) would not be attracted in the hands of Mr. A.

Note - If it is assumed that the agricultural land is an urban agricultural land, the tax implications would be as follows:

Mr. B, the seller, can consider the stamp duty value of ₹ 2.20 lakhs per acre on 10.3.2019, being the date of agreement, as the full value of consideration as per section 50C for computation of capital gains (instead of the stamp duty value of ₹ 3 lakhs per acre on 10.5.2019, being the date of sale), since he has received an advance of ₹ 1 lakh by account payee cheque at the time of entering into an agreement.

In the hands of the buyer, Mr. A, ₹ 2 lakhs would be taxable under section 56(2) as "Income from other sources", by considering the difference between the stamp duty value of ₹ 2.20 lakhs per acre on 10.3.2019 and the actual purchase price of ₹ 2 lakh per acre [(₹ 2.20 lakhs – ₹ 2 lakhs) x 10 acres].

(ii) Since the question mentions that B and C are Mr. A's distant relatives, it is assumed that they do not fall within the definition of "relative" under section 56(2).

Since cash gift exceeding ₹ 50,000 in aggregate from non-relatives, B & C, was received, not on the occasion of marriage but on the occasion of Mr. A's 61st birthday, the said sum of ₹ 5 lakhs [i.e., ₹ 4.75 lakhs from B and ₹ 25,000 from C] is taxable under section 56(2)(x) as "Income from Other Sources" in the hands of Mr. A.

(iii) Section 56(2)(x) excludes from its scope, any sum of money received from an individual by a trust created or established solely for the benefit of relative of the individual.

In this case, this exclusion would not apply, since ₹ 2 lakhs was received from Mr. Dileep by a trust created for the benefit of his friend's daughter and not his relative. Thus, ₹ 2 lakhs would be chargeable to tax in the hands of the trust.

CHAPTER - 9
Income of other Persons included in Assessee's Total Income

Section A – ICAI Study Material Questions

Question 1

Mr. A holds shares carrying 25% voting power in X Ltd. Mrs. A is working as a computer software programmer in X Ltd. at a salary of ₹ 30,000 p.m. She is, however, not qualified for the job. The other income of Mr. A & Mrs. A are ₹ 7,00,000 & ₹ 4,00,000, respectively. Compute the gross total income of Mr. A and Mrs. A for the A.Y.2020-21.

Will your answer be different if Mrs. A was qualified for the job?

Answer

Mr. A holds shares carrying 25% voting power in X Ltd i.e. a substantial interest in the company. His wife is working in the same company without any professional qualifications for the same. Thus, by virtue of the clubbing provisions of the Act, the salary received by Mrs. A from X Ltd. will be clubbed in the hands of Mr. A.

Computation of Gross total income of Mr. A

Particulars	₹	₹
Salary received by Mrs. A (₹ 30,000 × 12)	3,60,000	
Less: Standard deduction under section 16(ia)	50,000	3,10,000
Other Income		7,00,000
Gross total income		**10,10,000**

The gross total income of Mrs. A is ₹ 4,00,000.

If Mrs. A possesses professional qualifications for the job, then the clubbing provisions shall not be applicable.

Gross total income of Mr. A = ₹ 7,00,000 (other income)

Gross total income of Mrs. A = Salary received by Mrs. A [₹ 30,000×12] less ₹ 50,000, being the standard deduction under section 16(ia) plus other income [₹ 4,00,000] = ₹ 7,10,000

Question 2

Mr. B holds shares carrying 30% voting power in Y Ltd. Mrs. B is working as accountant in Y Ltd. getting income from salary (computed) of ₹ 3,44,000 without any qualification in accountancy. Mr. B also receives ₹ 30,000 as interest on securities. Mrs. B owns a house property which she has let out. Rent received from tenants is ₹ 6,000 p.m. Compute the gross total income of Mr. B and Mrs. B for the A.Y. 2020-21.

Answer

Since Mrs. B is not professionally qualified for the job, the clubbing provisions shall be applicable.

Computation of Gross total income of Mr. B

Particulars	₹
Income from Salary of Mrs. B (Computed)	3,44,000
Income from other sources	
- Interest on securities	30,000
	3,74,000

Computation of gross total income of Mrs. B

Particulars	₹	₹
Income from Salary [clubbed in the hands of Mr. B]		Nil
Income from house property		
Gross Annual Value [₹ 6,000 × 12]	72,000	
Less: Municipal taxes paid	-	
Net Annual Value (NAV)	**72,000**	
Less: Deductions under section 24		
- 30% of NAV i.e., 30% of ₹ 72,000	21,600	
- Interest on loan	-	50,400
Gross total income		**50,400**

Question 3

Mr. Vaibhav started a proprietary business on 01.04.2018 with a capital of ₹ 5,00,000. He incurred a loss of ₹ 2,00,000 during the year 2018-19. To overcome the financial position, his wife Mrs. Vaishaly, a software engineer, gave a gift of ₹ 5,00,000 on 01.04.2019, which was immediately invested in the business by Mr. Vaibhav. He earned a profit of ₹ 4,00,000 during the year 2019-20. Compute the amount to be clubbed in the hands of Mrs. Vaishaly for the Assessment Year 2020-21. If Mrs. Vaishaly gave the said amount as loan, what would be the amount to be clubbed?

Answer

Section 64(1)(iv) of the Income-tax Act, 1961 provides for the clubbing of income in the hands of the individual, if the income earned is from the assets (other than house property) transferred directly or indirectly to the spouse of the individual, otherwise than for adequate consideration or in connection with an agreement to live apart.

In this case, Mr. Vaibhav received a gift of ₹ 5,00,000 on 1.4.2019 from his wife Mrs. Vaishaly, which he invested in his business immediately. The income to be clubbed in the hands of Mrs. Vaishaly for the A.Y. 2020-21 is computed as under:

Particulars	Mr. Vaibhav's capital contribution (₹)	Capital contribution out of gift from Mrs. Vaishaly (₹)	Total (₹)
Capital as on 1.4.2019	3,00,000 (5,00,000 – 2,00,000)	5,00,000	8,00,000
Profit for P.Y.2019-20 to be apportioned on the basis of capital employed on the first day of the previous year i.e. as on 1.4.2019 (3:5)	1,50,000 (4,00,000*3/8)	2,50,000 (4,00,000*5/8)	4,00,000

Therefore, the income to be clubbed in the hands of Mrs. Vaishaly for the A.Y.2020-21 is ₹ 2,50,000.
In case Mrs. Vaishaly gave the said amount of ₹ 5,00,000 as a bona fide loan, then, clubbing provisions would not be attracted.

Question 4

Mrs. Kasturi transferred her immovable property to ABC Co. Ltd. subject to a condition that out of the rental income, a sum of ₹ 36,000 per annum shall be utilized for the benefit of her son's wife.

Mrs. Kasturi claims that the amount of ₹ 36,000 (utilized by her son's wife) should not be included in her total income as she no longer owned the property.

Examine with reasons whether the contention of Mrs. Kasturi is valid in law.

Answer

The clubbing provisions under section 64(1)(viii) are attracted in case of transfer of any asset, directly or indirectly, otherwise than for adequate consideration, to any person to the extent to which the income from such asset is for the immediate or deferred benefit of son's wife. Such income shall be included in computing the total income of the transferor-individual.

Therefore, income of ₹ 36,000 meant for the benefit of daughter-in-law is chargeable to tax in the hands of transferor i.e., Mrs. Kasturi in this case.

The contention of Mrs. Kasturi is, hence, not valid in law.

Note - In order to attract the clubbing provisions under section 64(1)(viii), the transfer should be otherwise than for adequate consideration. In this case, it is presumed that the transfer is otherwise than for adequate consideration and therefore, the clubbing provisions are attracted. In such case, the provisions of section 56(2)(x) will also get attracted in the hands of ABC Co Ltd., if stamp duty value exceeds ` 50,000 and the other conditions specified thereunder are satisfied.

Question 5

Mr. A has three minor children – two twin daughters and one son. Income of the twin daughters is ₹ 2,000 p.a. each and that of the son is ₹ 1,200 p.a. Compute the income, in respect of minor children, to be clubbed in the hands of Mr. A.

Answer

Taxable income, in respect of minor children, in the hands of Mr. A is

Particulars	₹	₹
Twin minor daughters [₹ 2,000 × 2]	4,000	
Less: Exempt under section 10(32) [₹ 1,500 × 2]	3,000	1,000
Minor son	1,200	
Less: Exempt under section 10(32)	1,200	Nil
Income to be clubbed in the hands of Mr. A		**1,000**

Question 6

Mr. Vasudevan gifted a sum of ₹ 6 lakhs to his brother's wife on 14-6-2019. On 12-7-2019, his brother gifted a sum of ₹ 5 lakhs to Mr. Vasudevan's wife. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and wife of Mr. Vasudevan's brother on 01-8-2019 at 9% interest. Discuss the consequences of the above under the provisions of the Income-tax Act, 1961 in the hands of Mr. Vasudevan and his brother.

Answer

In the given case, Mr. Vasudevan gifted a sum of ₹ 6 lakhs to his brother's wife on 14.06.2019 and simultaneously, his brother gifted a sum of ₹ 5 lakhs to Mr. Vasudevan's wife on 12.07.2019. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and his brother's wife. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

If two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. It was so held by the Apex Court in CIT vs. Keshavji Morarji (1967) 66 ITR 142.

Accordingly, the interest income arising to Mrs. Vasudevan in the form of interest on fixed deposits would be included in the total income of Mr. Vasudevan and interest income arising in the hands of his brother's wife would be taxable in the hands of Mr. Vasudevan's brother as per section 64(1), to the extent of amount of cross transfers i.e., ₹ 5 lakhs.

This is because both Mr. Vasudevan and his brother are the indirect transferors of the income to their respective spouses with an intention to reduce their burden of taxation.

However, the interest income earned by his spouse on fixed deposit of ₹ 5 lakhs alone would be included in the hands of Mr. Vasudevan's brother and not the interest income on the entire fixed deposit of ₹ 6 lakhs, since the cross transfer is only to the extent of ₹ 5 lakhs.

Question 7

Mr. Ravi has gifted his only house property to his wife, Mrs. Ravi, and his married daughter, Mrs. Divya. The Assessing Officer has served a notice of demand on Mr. Ravi for payment of tax for the income derived from the said house property. Examine the validity of the Assessing Officer's action.

Answer

As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, or to a minor child not being a married daughter shall be deemed to be the owner of the house property so transferred.

Mr. Ravi, in this case, would be the deemed owner only in respect of the share of house property transferred to his wife Mrs. Ravi without consideration and not for the share of the house property transferred to his married daughter Mrs. Divya.

Since Mr. Ravi is the deemed owner of the share of house property transferred to his wife without consideration, the income derived from the house property, to the extent attributable to the share of property transferred to his wife without consideration, would be taxable in his hands under the head "Income from house property".

As per section 65, the notice of demand can, however, be served on Mrs. Ravi for payment of that portion of tax levied on Mr. Ravi attributable to the income derived [by virtue of section 27(i)], from the share of house property transferred to Mrs. Ravi, and standing in her name.

However, the income derived from house property, attributable to the share of property transferred to his married daughter without consideration, would be taxable in the hands of his daughter. Such income would not be taxable in the hands of Mr. Ravi. Mr. Ravi will not be responsible for the payment of tax attributable to aforesaid share of income of daughter from house property.

Thus, the action of the Assessing Officer in serving notice of demand on Mr. Ravi for payment of tax for the entire income derived from the said house property is not valid.

Question 8

Mrs. E, wife of Mr. F, is a partner in a firm. Her capital contribution to the firm as on 01-04-2019 was ₹ 5 lacs, out of which ₹ 3 lacs was contributed out of her own sources and ₹ 2 lacs was contributed out of gift from her husband. As further capital was needed by the firm, she further invested ₹ 2 lacs on 01.05.2019 out of the funds gifted by her husband. The firm paid interest on capital of ₹ 80,000 and share of profit of ₹ 60,000 for the financial year 2019-20.

Advise Mr. F as to the applicability of the provisions of section 64(1)(iv) and the manner thereof in respect of the above referred transactions.

Answer

As per section 64(1)(iv), in computing the total income of any individual, there shall be included all such income as arises, directly or indirectly, subject to the provisions of section 27(i), to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

In this instant case, Mr. F has gifted money to his wife, Mrs. E. Mrs. E, in turn, invested such gifted money in the capital of a partnership firm, of which she is a partner. Mrs. E has also contributed a sum of ₹ 3 lacs out of her own resources to the capital of the firm.

As per Explanation 3 to section 64(1), for the purpose of clubbing under section 64(1)(iv), where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the nature of contribution of capital as a partner in a firm, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment by way of capital contribution as a partner in the firm as on that day.

In view of the above provision, interest received by Mrs. E from the firm shall be included in total income of Mr. F to the extent of ₹ 32,000 i.e., ₹ 80,000 x ₹ 2,00,000/ ₹ 5,00,000.

Share of profit amounting to ₹ 60,000 is exempt from income-tax under the provisions of section 10(2A). The provisions of section 64 will not apply, if the income from the transferred asset itself is exempt from tax.

Note: It is assumed that rate of interest on capital contributed by Mrs. E does not exceed 12% p.a.

Question 9

Mr. A has gifted a house property valued at ₹ 50 lakhs to his wife, Mrs. B, who in turn has gifted the same to Mrs. C, their daughter-in-law. The house was let out at ₹ 25,000 per month throughout the year. Compute the total income of Mr. A and Mrs. C.

Will your answer be different if the said property was gifted to his son, husband of Mrs. C?

Answer

As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, shall be deemed to be the owner of the house property so transferred.

Therefore, in this case, Mr. A would be the deemed owner of the house property transferred to his wife Mrs. B without consideration.

As per section 64(1)(vi), income arising to the son's wife from assets transferred, directly or indirectly, to her by an individual otherwise than for adequate consideration would be included in

the total income of such individual.

Income from let-out property is ₹ 2,10,000 [i.e., ₹ 3,00,000, being the actual rent calculated at

₹ 25,000 per month less ₹ 90,000, being deduction under section 24 @30% of ₹ 3,00,000]

In this case, income of ₹ 2,10,000 from let-out property arising to Mrs. C, being Mr. A's son's wife, would be included in the income of Mr. A, applying the provisions of section 27(i) and section 64(1)(vi). Such income would, therefore, not be taxable in the hands of Mrs. C.

In case the property was gifted to Mr. A's son, the clubbing provisions under section 64 would not apply, since the son is not a minor child. Therefore, the income of ₹ 2,10,000 from letting out of property gifted to the son would be taxable in the hands of the son.

It may be noted that the provisions of section 56(2)(x) would not be attracted in the hands of the recipient of house property, since the receipt of property in each case was from a "relative" of such individual. Therefore, the stamp duty value of house property would not be chargeable to tax in the hands of the recipient of immovable property, even though the house property was received by her or him without consideration.

Note - The first part of the question can also be answered by applying the provisions of section 64(1)(vi) directly to include the income of ₹ 2,10,000 arising to Mrs. C in the hands of Mr. A. [without first applying the provisions of section 27(i) to deem Mr. A as the owner of the house property transferred to his wife Mrs. B without consideration], since section 64(1)(vi) speaks of clubbing of income arising to son's wife from indirect transfer of assets to her by her husband's parent, without consideration. Gift of house property by Mr. A to Mrs. C, via Mrs. B, can be viewed as an indirect transfer by Mr. A to Mrs. C.

Question 10

Mr. Korani transferred 2,000 debentures of ₹ 100 each of Wild Fox Ltd. to his wife Mrs. Rekha Korani on 3.10.2018 without consideration. The company paid interest of ₹ 30,000 in September, 2019 which was deposited by Mrs. Korani with Kartar Finance Co. in October, 2019. Kartar Finance Co. paid interest of ₹ 3,000 upto March, 2020. How would both the interest income be charged to tax in A.Y. 2020-21?

Answer

As per section 64(1)(iv), income arising from assets transferred without adequate consideration by an individual to his spouse is liable to be clubbed in the hands of the individual. It may be noted that income on the asset transferred has to be clubbed but if there is accretion to the asset, any further income derived on such accretion should not be clubbed.

Therefore, applying the provisions of section 64(1)(iv), ₹ 30,000, being the interest on debentures received by Mrs. Rekha Korani in September, 2019 will be clubbed with the income of Mr. Korani, since he had transferred the debentures of the company without consideration to her in October, 2018.

However, the interest of ₹ 3,000 upto March, 2020 earned by Mrs. Rekha Korani on the interest on the debentures deposited by her with Kartar Finance Company shall be taxable in her individual capacity and will not be clubbed with the income of Mr. Korani.

Question 11

Mr. Rose, out of his own funds, had taken an FDR for ₹ 10,00,000 bearing interest @10% p.a. payable half-yearly in the name of his wife Lilly. The interest earned during the financial year

2019- 20 of ₹ 1,00,000 was invested by Mrs. Lilly in the business of packed spices which resulted in a net profit of ₹ 55,000 for the year ended 31.03.2020. How shall the interest on FDR and income from business be taxed for the Assessment Year 2020-21?

Answer

Section 64(1)(iv) specifies that the income derived by the spouse of an assessee from the assets transferred directly or indirectly without adequate consideration or intention to live apart shall be clubbed with the income of the transferor. Therefore, the interest income of ₹ 1 lac on the FDR of ₹ 10 lacs for the F.Y.2019-20 shall be clubbed with the income of Mr. Rose.

When Mrs. Lilly invested the interest income in a business and earned profits therefrom, such profits shall not be clubbed with the income of her husband but shall be taxable in her individual capacity. This is so because the income from the accretion of the transferred assets is not to be clubbed with the income of the transferor [CIT v. M. S. S. Rajan (2001) 252 ITR 126 (Mad)].

Question 12

Naresh is a fashion designer having lucrative business. His wife is a model. Naresh pays her monthly salary of ₹ 10,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of Naresh had applied the provisions of section 64(1), and had clubbed the income (salary) of his wife in Naresh hands.

Discuss the correctness of the action of the Assessing Officer.

Answer

This question is based on the principles laid down by Madras High Court in the case of CIT v. Smt. R. Bharati (1999) 240 ITR 697 where the interpretation of the terms "professional qualifications" and "knowledge" came up for consideration as per proviso to section 64(1).

These words do not necessarily connote a qualification conferred by a recognized university after examining the candidate who has undergone a course of study in a technical subject or course of study preparing him for a profession of law, accountancy etc. Accordingly, the term "qualification" must be given a wide meaning as referring to the qualities which are required to be possessed by a person performing the work that he does, so long as that work is capable of being regarded as technical or professional.

The word "professional" is a term capable of very broad meaning and would encompass a variety of occupations. A large number of occupations are being practiced which form a source of livelihood and are capable of being regarded, as professions as long as they require certain degree of skill. A person having skill, experience and competence in a line of work can be regarded as professionally qualified for the purpose of section 64(1)(ii).

Applying the rationale of the Madras High Court ruling, a model, having skill, competence and experience in her line can be considered as a professional. Hence, the action of the Assessing Officer is not correct.

Section B – Additional Questions

Question 13

Explain in brief about the treatment to be given in the following case under the Income-tax Act, 1961, for A.Y. 2020-21:

Interest of ₹ 20,000 on bank FDRs received by minor son of Rajesh. These FDRs were made by the minor son out of his earnings from stage acting.

Answer

According to section 64(1A), all income accruing or arising to a minor is to be included in the income of his parent, whose total income [excluding the income includible under section 64(1A)] is higher. The income derived by the minor from manual work or from any activity involving his skill, talent or specialised knowledge or experience will not be included in the income of his parent.

Since interest of ₹ 20,000 on bank FDRs received by minor son of Rajesh does not arise to minor on account of his manual work or on account of an activity involving his skill, talent or specialized knowledge or experience, therefore, such interest should be included in income of Mr. Rajesh or Mrs. Rajesh, whosoever total income (before including minor's income) is higher. However, exemption of ₹ 1,500 under section 10(32) shall be provided from interest of ₹ 20,000 to be clubbed.

Question 14

In the following cases discuss whether the loss could be set off:

(i) Smt. Shanti carried on business with gifted funds of her husband Mahesh. For the financial year 2019-20, Shanti incurred loss of ₹ 2 Lacs which loss Mahesh wants to set- off from his taxable income.

(ii) Smt. Bhanu succeeded to the business of her husband Sri. Bhavesh who died on 10th September, 2019. She carried on the business as proprietrix. The business of Bhavesh upto the date of his death resulted in a loss. Smt. Bhanu earned profit in business for the period ending 31.03.2020. Bhanu wants to set off the loss of her husband for the period ending 10th September, 2019 against her income.

Answer

(i) Under section 64(1)(iv), where any asset is transferred directly or indirectly to the spouse by an individual, otherwise than for adequate consideration or in connection with an agreement to live apart, the income arising therefrom is included in the hands of the transferor. The term "income" in this context includes "loss" as well. Therefore, the loss sustained by Shanti in the business carried on by her with funds gifted by her husband can be set off by her husband.

(ii) Section 78(2) says that where any person carrying on any business or profession is succeeded in such capacity by another person otherwise than by inheritance, no person other than the person incurring the loss is entitled to carry forward the loss and set it off against his income.
The facts of the case seem to indicate that Smt. Bhanu has succeeded to the business by inheritance and is not affected by the provisions of section 78(2). Therefore, she is eligible to carry forward and set off the loss of her husband against her own income. Succession by inheritance is an exception to the general bar contained in section 78(2) against carry forward and set off of losses of predecessor.

Question 15

Dinesh, an individual engaged in the business of finance, advances ₹ 5 lacs to his HUF on interest at 12% p.a., which is the prevailing market rate. The HUF invests the amount in its business and earns profit of ₹ 2 lacs from this money. Can the Assessing Officer add a sum of ₹ 1,40,000 (i.e. ₹ 2,00,000-₹ 60,000) as income of Dinesh under section 64(2) of the Income-tax Act, 1961?

Answer

Section 64(2) shall be applicable only where an individual member of HUF converts his property into the property of HUF or throws it into the common stock of the HUF without adequate consideration.

In this case, Dinesh does not transfer money to his HUF but only lends an amount of ₹ 5 Lacs to his HUF at an interest of 12%, which is the prevailing market rate. This is a transaction of loan, which pre-supposes, repayment. Dinesh continues to be the owner of the amount lent. Thus, there is no transfer of property from Dinesh to the HUF. Therefore, the Assessing Officer cannot add the profit arising to HUF in the total income of Dinesh by invoking section 64(2).

CHAPTER - 10
Set off and Carry forward of Losses

Section A – ICAI Study Material Questions

Question 1

Mr. A (aged 35 years) submits the following particulars pertaining to the A.Y.2020-21:

Particulars	₹
Income from salary (computed)	4,00,000
Loss from self-occupied property	(-)70,000
Loss from let-out property	(-) 1,50,000
Business loss	(-)1,00,000
Bank interest (FD) received	80,000

Compute the total income of Mr. A for the A.Y.2020-21.

Answer

Computation of total income of Mr. A for the A.Y.2020-21

Particulars	Amount (₹)	Amount (₹)
Income from salary	4,00,000	
Less: Loss from house property of ₹ 2,20,000 to be restricted to ₹ 2 lakhs by virtue of section 71(3A)	(-) 2,00,000	2,00,000
Balance loss of ₹ 20,000 from house property to be carried forward to next assessment year		
Income from other sources (interest on fixed deposit with bank)	80,000	
Business loss set-off (Business loss of ₹ 20,000 to be carried forward for set-off against business income of the next assessment year)	(-) 1,00,000	-
Gross total income [See Note below]		**2,00,000**
Less: Deduction under Chapter VI-A		Nil
Total income		**2,00,000**

Note: Gross Total Income includes salary income of ₹ 2,00,000 after adjusting loss of ₹ 2,00,000 from house property. The balance loss of ₹ 20,000 from house property to be carried forward to next assessment year for set-off against income from house property of that year.

Business loss of ₹ 1,00,000 is set off against bank interest of ₹ 80,000 and remaining business loss of ₹ 20,000 will be carried forward as it cannot be set off against salary income.

Question 2

Mr. B, a resident individual, furnishes the following particulars for the P.Y.2019-20:

Particulars	₹
Income from salary (computed)	45,000
Income from house property	(24,000)
Income from business – non-speculative	(22,000)
Income from speculative business	(4,000)

Short-term capital losses	25,000
Long-term capital gains u/s 112	19,000

What is the total income chargeable to tax for the A.Y.2020-21?

Answer

Total income of Mr. B for the A.Y. 2020-21

Particulars	Amount (₹)	Amount (₹)
Income from salaries	45,000	
Income from house property	(24,000)	21,000
Profits and gains of business and profession		
Business loss to be carried forward **[Note 1]**	(22,000)	
Speculative loss to be carried forward **[Note 2]**	(4,000)	
Capital Gains		
Long term capital gain	19,000	
Short term capital loss	(25,000)	
Short term capital loss to be carried forward **[Note 3]**	(6,000)	-
Taxable income		**21,000**

Note 1: Business loss cannot be set-off against salary income. Therefore, loss of ₹ 22,000 from the non-speculative business cannot be set off against the income from salaries. Hence, such loss has to be carried forward to the next year for set-off against business profits, if any.

Note 2: Loss of ₹ 4,000 from the speculative business can be set off only against the income from the speculative business. Hence, such loss has to be carried forward.

Note 3: Short term capital loss can be set off against both short term capital gain and long term capital gain. Therefore, short term capital loss of ₹ 25,000 can be set-off against long-term capital gains to the extent of ₹ 19,000. The balance short term capital loss of ₹ 6,000 cannot be set-off against any other income and has to be carried forward to the next year for set-off against capital gains, if any.

Question 3

During the P.Y. 2019-20, Mr. C has the following income and the brought forward losses:

Particulars	₹
Short term capital gains on sale of shares	1,50,000
Brought forward Long term capital loss of A.Y.2018-19	(96,000)
Short term capital loss of A.Y.2019-20	(37,000)
Long term capital gain	75,000

What is the capital gain taxable in the hands of Mr. C for the A.Y.2020-21?

Answer

Taxable capital gains of Mr. C for the A.Y. 2020-21

Particulars	₹	₹
Short term capital gains on sale of shares	1,50,000	
Less: Brought forward short term capital loss of the A.Y.2019-20	(37,000)	1,13,000
Long term capital gain	75,000	
Less: Brought forward long term capital loss of A.Y.2018-19 **[See Note below]**	(75,000)	Nil
Taxable short-term capital gains		**1,13,000**

Note: Long-term capital loss cannot be set off against short-term capital gain. Hence, the unadjusted long term capital loss of A.Y.2018-19 of ₹ 21,000 (i.e. ₹ 96,000 – ₹ 75,000) has to be carried forward to the next year to be set-off against long-term capital gains of that year.

Question 4

Mr. D has the following income for the P.Y.2019-20-

Particulars	₹
Income from the activity of owning and maintaining the race horses	75,000
Income from textile business	85,000
Brought forward textile business loss	(50,000)
Brought forward loss from the activity of owning and maintaining the race horses (relating to A.Y.2017-18)	(96,000)

What is the total income in the hands of Mr. D for the A.Y. 2020-21?

Answer

Total income of Mr. D for the A.Y. 2020-21

Particulars	₹	₹
Income from the activity of owning and maintaining race horses	75,000	
Less: Brought forward loss from the activity of owning and maintaining race horses	96,000	
Loss from the activity of owning and maintaining race horses to be carried forward to A.Y.2021-22	(21,000)	
Income from textile business	85,000	
Less: Brought forward business loss from textile business	50,000	35,000
Total income		**35,000**

Note: Loss from the activity of owning and maintaining race horses cannot be set-off against any other source/head of income.

Question 5

Mr. E has furnished his details for the A.Y.2020-21 as under:

Particulars	₹
Income from salaries (computed)	1,50,000

Income from speculation business	60,000
Loss from non-speculation business	(40,000)
Short term capital gain	80,000
Long term capital loss of A.Y.2018-19	(30,000)
Winning from lotteries	20,000

What is the taxable income of Mr. E for the A.Y.2020-21?

Answer

Computation of taxable income of Mr. E for the A.Y.2020-21

Particulars	₹	₹
Income from salaries		1,50,000
Income from speculation business	60,000	
Less: Loss from non-speculation business	(40,000)	20,000
Short-term capital gain		80,000
Winnings from lotteries		20,000
Taxable income		**2,70,000**

Note: Long term capital loss can be set off only against long term capital gain. Therefore, long term capital loss of ₹ 30,000 has to be carried forward to the next assessment year.

Question 6

Compute the gross total income of Mr. F for the A.Y.2020-21 from the information given below –

Particulars	₹
Income from house property (computed)	1,25,000
Income from business (before providing for depreciation)	1,35,000
Short term capital gains on sale of shares	56,000
Long term capital loss from sale of property (brought forward from A.Y.2017-18)	(90,000)
Income from tea business	1,20,000
Dividends from Indian companies carrying on agricultural operations	80,000
Current year depreciation	26,000
Brought forward business loss (loss incurred six years ago)	(45,000)

Answer

Gross Total Income of Mr. F for the A.Y. 2020-21

Particulars	₹	₹
Income from house property		1,25,000
Income from business		
Profits before depreciation	1,35,000	
Less: Current year depreciation	26,000	
Less: Brought forward business loss	45,000	
	64,000	
Income from tea business (40% is business income)	48,000	1,12,000

Income from the capital gains		
Short term capital gains		56,000
Gross Total Income		**2,93,000**

Notes:

(1) Dividend from Indian companies of ₹ 80,000 is exempt from tax under section 10(34).

(2) 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax;

(3) Long-term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss of ₹ 90,000 brought forward from A.Y.2017-18 cannot be set-off in the A.Y.2020-21. It has to be carried forward for set-off against long-term capital gains, if any, during A.Y.2021-22.

Question 7

X carrying on a business as sole proprietor, died on 31st March, 2019. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2019, a determined business loss of ₹ 5 lacs is to be carried forward under the Income-tax Act, 1961.

Does the firm consisting of all legal heirs of Mr. X, get a right to have this loss adjusted against its current income?

Answer

Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case CIT v. Madhukant M. Mehta (2001) 247 ITR 805, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In this case, the business of X was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of ₹ 5 lacs of X.

Question 8

ABC Limited was amalgamated with XYZ Limited on 01.04.2019. All the conditions of section 2(1B) were satisfied.

ABC Limited has the following carried forward losses as assessed till the Assessment Year 2019-20:

	Particulars	₹ (in lacs)
(i)	Speculative Loss	4
(ii)	Unabsorbed Depreciation	18
(iii)	Unabsorbed expenditure of capital nature on scientific research	2

(iv)	Business Loss	120

XYZ Limited has computed a profit of ₹ 140 lacs for the financial year 2019-20 before setting off the eligible losses of ABC Limited but after providing depreciation at 15% per annum on ₹ 150 lacs, being the consideration at which plant and machinery were transferred to XYZ Limited. The written down value as per Income-tax record of ABC Limited as on 1st April, 2019 was ₹ 100 lacs.

The above profit of XYZ Limited includes speculative profit of ₹ 10 lacs.

Compute the total income of XYZ Limited for Assessment Year 2020-21 and indicate the losses/ other allowances to be carried forward by it.

Answer

Computation of total income of XYZ Limited for the A.Y. 2020-21

Particulars	₹(in lacs)	
Business income before setting-off brought forward losses of ABC Ltd.		140.00
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Limited with XYZ Limited.		
Value at which assets are transferred by ABC Ltd.	150	
WDV in the books of ABC Ltd.	100	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of XYZ Ltd. [₹ 50 lacs × 15 %] [Explanation 2 to section 43(6)]		7.50
		147.50
Set-off of brought forward business loss of ABC Ltd. **(See Notes 2 & 4)**		(120.00)
Set-off of unabsorbed depreciation under section 32(2) read with section 72A **(See Notes 2 & 4)**		(18.00)
Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) **(See Note 5)**		(2.00)
Business income		7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income- tax Act, 1961.
2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.
3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of ₹ 4 lacs of ABC Ltd. cannot be carried forward by XYZ Ltd.
4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business

losses under section 72.

5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.

6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business.

   Consequently, there is no loss or allowance to be carried forward by XYZ Ltd. to the F.Y. 2020-21.

Question 9

Examine in brief about the treatment to be given in the following case under the Income-tax Act, 1961, for A.Y.2020-21:
A loss of ₹ 85,000 was sustained by Simran in the activity of owning and maintaining camels for races.

Answer

Section 74A(3) lays down the provisions for set-off and carry forward of loss from the activity of owning and maintaining race horses. According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses. Since the scope of this section is confined to the activity of owning and maintaining race horses only, therefore, set-off and carry forward of loss from the activity of owning and maintaining camels is not covered under section 74A(3).

It is possible to take a view that the loss from the activity of owning and maintaining camels for races may be governed by section 72 provided such activity amounts to business. Accordingly, the loss from the activity of owning and maintaining of camels for races can be set-off against any income (other than income from salary) of current year and unadjusted amount shall be carried forward for set off against any business income for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

Question 10

M/s. JKLM, a firm, consists of four partners namely, J, K, L and M. They shared profits and losses equally during the year ended 31.3.2019. The assessed business loss of the firm for the assessment year 2019-20 which it is entitled to carry forward amounts to ₹ 3,60,000. A new deed of partnership was executed among J, K, L and M on 1.4.2019 in terms of which they agreed to share profits and losses in the ratio of 15:15:20:50 respectively.
Compute the amount of business loss relating to the assessment year 2019-20, which the firm is entitled to set off against its business income for the assessment year 2020-21. The business income of the firm for the assessment year 2020-21 is ₹ 3,30,000. Your answer should be supported by reasons.

Answer

The firm is entitled to set off its brought forward business loss amounting to ₹ 3,60,000 relating to the assessment year 2019-20 to the extent of ₹ 3,30,000 against its business income of ₹ 3,30,000 for the assessment year 2020-21, as per the provisions of section 72(1).

The balance unabsorbed business loss of ₹ 30,000 relating to the assessment year 2019-20 will be carried forward to assessment year 2021-22.

Section 78(1) which deals with carry forward and set-off of losses in the case of change in constitution of firm is applicable only where there is retirement or death of a partner. **It is not applicable to a case where there is a change in the ratio of sharing profits and losses amongst the existing partners.** Therefore, section 78(1) is not applicable to the case of M/s. JKLM.

Question 11

An assessee sustained a loss under the head "Income from house property" in the previous year relevant to the assessment year 2019-20, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed under section 139(4). Can the assessee carry forward such loss for set off against income from house property of the assessment year 2020-21?

Answer

Section 139(3) stipulates that an assessee claiming carry forward of loss under the heads "Profits and gains of business or profession" or "Capital gains" should furnish the return of loss within the time stipulated under section 139(1). There is no reference to loss under the head "Income from house property" in section 139(3). The assessee, in the instant case, has filed the return showing loss from property within the time prescribed under section 139(4). The assessee is, therefore, entitled to carry forward such loss for set off against the income from house property of the subsequent assessment year.

Section B – Additional Questions

Question 12

A private limited company has share capital in the form of equity share capital. The shares were held up till 31st March, 2018 by four members A, B, C and D equally. The company made losses/profits for the past three assessment years as follows:

Assessment Year	Business Loss ₹	Unabsorbed Depreciation ₹	Total ₹
2016-17	Nil	15,00,000	15,00,000
2017-18	Nil	12,00,000	12,00,000
2018-19	9,00,000	9,00,000	18,00,000
Total	**9,00,000**	**36,00,000**	**45,00,000**

The above figures have been accepted by the tax department.

During the previous year ended 31.3.2019, A sold his shares to Y and during the previous year ended 31.3.2020, B sold his shares to Z. The profits for the past two previous years are as follows:

31.3.2019 ₹ 18,00,000 (before charging depreciation of ₹ 9,00,000)

31.3.2020 ₹ 45,00,000 (before charging depreciation of ₹ 7,50,000)

Compute taxable income for A.Y.2020-21. Workings must form part of your answer.

Answer

A, B, C and D are the four shareholders of a private limited company. The shareholding pattern of the company in the last three financial years are given below:

As on 31st day of March	A	B	C	D	Y	Z
	%	%	%	%	%	%
2018	**25**	**25**	**25**	**25**	**-**	**-**
2019	**-**	**25**	**25**	**25**	**25**	**-**
2020	**-**	**-**	**25**	**25**	**25**	**25**

Section 79 provides that, in case of a closely held company, no loss incurred in the previous year shall be carried forward and set off against the income of the subsequent previous year unless the shares carrying at least 51% of the voting power of the company are beneficially held on the last day of the previous year in which the loss is sought to be set off, by the same shareholders, who beneficially held the shares carrying at least 51% of the voting power on the last day of the previous year in which the loss was incurred.

Since shareholders holding at least 51% of the voting power are the same in the first and second year, the restriction imposed by section 79 is not applicable for the second year. Thus, the taxable income for the assessment year 2019-20 would be:

Particulars	₹
Business profit	18,00,000
Less: Current year's depreciation	9,00,000
	9,00,000
Less: Brought forward business loss [as per section 72(2)]	9,00,000
Taxable income	**Nil**

Unabsorbed depreciation relating to the earlier assessment years can be carried forward to the next assessment year i.e., A.Y. 2020-21. There is no brought forward business loss and

section 79 is not applicable in case of carry forward of unabsorbed depreciation. Section 32 governs the carry forward and set off of depreciation for which the shareholding pattern is not relevant at all. Consequently, the income for A.Y.2020-21 will be determined as under -

Particulars	₹	₹
Business income		45,00,000
Less: Current year's depreciation		7,50,000
		37,50,000
Less: Unabsorbed depreciation:-		
Assessment year 2016-17	15,00,000	
Assessment year 2017-18	12,00,000	
Assessment year 2018-19	9,00,000	36,00,000
Taxable Income for A.Y.2020-21		**1,50,000**

Question 13

X Ltd., a pharmaceutical company having accumulated losses and unabsorbed depreciation to be set off in future for ₹ 130 lacs and ₹ 250 lacs as on 31.3.2019 was demerged on 16.5.2019 and 30% of its total assets were transferred to the resulting company, XY Ltd. How shall the accumulated losses and unabsorbed depreciation of the demerged company be dealt with in the return for Assessment Year 2020-21 of the resulting company:

(i) When the same are not directly relatable to the undertakings transferred and

(ii) When the same are directly relatable to the undertakings transferred.

Answer

The accumulated business loss and unabsorbed depreciation of the demerged company shall be carried forward and set off by the resulting company under section 72A(4) in the following manner:

(i) Where such loss or unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting company, such loss shall be apportioned between the demerged company and the resulting company in the same proportion in which assets of the undertaking have been retained by the demerged company and transferred to the resulting company and shall be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be. In this case, therefore, 30% of ₹ 130 lacs and ₹ 250 lacs, shall be allowed to be carried forward and set off by the resulting company and the balance by the demerged company.

(ii) Where such loss or unabsorbed depreciation is directly relatable to the undertaking transferred to the resulting company, the entire loss or unabsorbed depreciation shall be allowed to be carried forward and set off in the hands of the resulting company. Accordingly, in such a case, the entire amount of ₹ 130 lacs and ₹ 250 lacs shall be allowed to be set off in the hands of the resulting company.

CHAPTER - 11
Deductions from Gross Total Income

Section A – ICAI Study Material Questions

Question 1

Mr. A, aged about 40 years, has earned a lottery income of ₹ 1,20,000 (gross) during the P.Y. 2019-20. He also has interest on Fixed Deposit of ₹ 30,000. He invested an amount of ₹ 10,000 in Public Provident Fund account and ₹ 24,000 in National Savings Certificate. What is the total income of Mr. A for the A.Y.2020-21?

Answer

Computation of total income of Mr. A for A.Y.2020-21

Particulars	₹	₹
Income from Other Sources		
- Interest on Fixed Deposit		30,000
- Lottery income		1,20,000
Gross Total Income		**1,50,000**
Less: **Deductions under Chapter VIA [See Note below]**		
Under section 80C		
- Deposit in Public Provident Fund	10,000	
- Investment in National Savings Certificate	24,000	
	34,000	
Restricted to		30,000
Total Income		**1,20,000**

Question 2

The basic salary of Mr. A is ₹ 1,00,000 p.m. He is entitled to dearness allowance, which is 40% of basic salary. 50% of dearness allowance forms part of pay for retirement benefits. Both Mr. A and his employer contribute 15% of basic salary to the pension scheme referred to in section 80CCD. Examine the tax treatment in respect of such contribution in the hands of Mr. A.

Answer

Tax treatment in the hands of Mr. A in respect of employer's and own contribution to pension scheme referred to in section 80CCD

(a) Employer's contribution to such pension scheme would be treated as salary since it is specifically included in the definition of "salary" under section 17(1)(viii). Therefore, ₹ 1,80,000, being 15% of basic salary of ₹ 12,00,000, will be included in Mr. A's salary.

(b) Mr. A's contribution to pension scheme is allowable as deduction under section 80CCD(1). However, the deduction is restricted to 10% of salary. Salary, for this purpose, means basic pay plus dearness allowance, if it forms part of pay.

Therefore, deduction under section 80CCD for Mr. A would be –

Particulars	₹
Basic salary = ₹ 1,00,000 × 12 =	12,00,000

Dearness allowance = 40% of ₹ 12,00,000 = ₹ 4,80,000	
50% of Dearness Allowance forms part of pay = 50% of ₹ 4,80,000	2,40,000
Salary for the purpose of deduction under section 80CCD	**14,40,000**
Deduction under section 80CCD(1) is restricted to 10% of ₹ 14,40,000 (as against actual contribution of ₹ 1,80,000, being 15% of basic salary of ₹ 12,00,000)	1,44,000
As per section 80CCD(1B), a further deduction of upto ₹ 50,000 is allowable. Therefore, deduction under section 80CCD(1B) is ₹ 36,000 (₹ 1,80,000 - ₹ 1,44,000).	36,000

₹ 1,44,000 is allowable as deduction under section 80CCD(1). This would be taken into consideration and be subject to the overall limit of ₹ 1,50,000 under section 80CCE.

₹ 36,000 allowable as deduction under section 80CCD(1B) is outside the overall limit of ₹ 1,50,000 under section 80CCE.

In the alternative, ₹ 50,000 can be claimed as deduction under section 80CCD(1B). The balance ₹ 1,30,000 (₹ 1,80,000 - ₹ 50,000) can be claimed as deduction under section 80CCD(1).

(c) Employer's contribution to pension scheme would be allowable as deduction under section 80CCD(2), subject to a maximum of 10% of salary. Therefore, deduction under section 80CCD(2), would also be restricted to ₹ 1,44,000, even though the entire employer's contribution of ₹ 1,80,000 is included in salary under section 17(1)(viii). However, this deduction of employer's contribution of ₹ 1,44,000 to pension scheme would be outside the overall limit of ₹ 1,50,000 under section 80CCE i.e., this deduction would be over and above the other deductions which are subject to the limit of ₹ 1,50,000.

Question 3

The gross total income of Mr. X for the A.Y.2020-21 is ₹ 8,00,000. He has made the following investments/ payments during the F.Y.2019-20 –

Particulars	₹
(1) Contribution to PPF	1,10,000
(2) Payment of tuition fees to Apeejay School, New Delhi, for education of his son studying in Class XI	45,000
(3) Repayment of housing loan taken from Standard Chartered Bank	25,000
(4) Contribution to approved pension fund of LIC	1,05,000

Compute the eligible deduction under Chapter VI-A for the A.Y.2020-21.

Answer

Computation of deduction under Chapter VI-A for the A.Y.2020-21

Particulars	₹
Deduction under section 80C	
- Contribution to PPF	1,10,000
- Payment of tuition fees to Apeejay School, New Delhi, for education of his son studying in Class XI	45,000
- Repayment of housing loan	25,000
	1,80,000

Restricted to ₹ 1,50,000, being the maximum permissible deduction u/s 80C	1,50,000
Deduction under section 80CCC	
- Contribution to approved pension fund of LIC	1,05,000
	2,55,000
As per section 80CCE, the aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1,50,000	
Deduction allowable under Chapter VIA for the A.Y.2020-21	**1,50,000**

Question 4

Mr. A, aged 40 years, paid medical insurance premium of ₹ 20,000 during the P.Y.2019-20 to insure his health as well as the health of his spouse. He also paid medical insurance premium of ₹ 47,000 during the year to insure the health of his father, aged 63 years, who is not dependant on him. He contributed ₹ 3,600 to Central Government Health Scheme during the year. He has incurred ₹ 3,000 in cash on preventive health check-up of himself and his spouse and ₹ 4,000 by cheque on preventive health check-up of his father. Compute the deduction allowable under section 80D for the A.Y. 2020-21.

Answer

Deduction allowable under section 80D for the A.Y.2020-21

	Particulars	Actual Payment ₹	Maximum deduction allowable ₹
A.	**Premium paid and medical expenditure incurred for self and spouse**		
(i)	Medical insurance premium paid for self and spouse	20,000	20,000
(ii)	Contribution to CGHS	3,600	3,600
(iii)	Exp. on preventive health check-up of self & spouse	3,000	1,400
		26,600	**25,000**
B.	**Premium paid and medical expenditure incurred for father, who is a senior citizen**		
(i)	Mediclaim premium paid for father, who is over 60 years of age	47,000	47,000
(ii)	Expenditure on preventive health check-up of father	4,000	3,000
		51,000	**50,000**
	Total deduction under section 80D (₹ 25,000 + ₹ 50,000)		75,000

Notes:

(1) The total deduction under A.(i), (ii) and (iii) above should not exceed ₹ 25,000. Therefore, the expenditure on preventive health check-up for self and spouse would be restricted to ₹ 1,400, being (₹ 25,000 – ₹ 20,000 – ₹ 3,600).

(2) The total deduction under B. (i) and (ii) above should not exceed ₹ 50,000. Therefore, the expenditure on preventive health check-up for father would be restricted to ₹ 3,000, being (₹ 50,000 – ₹ 47,000).

(3) In this case, the total deduction allowed on account of expenditure on preventive health check-up of self, spouse and father is ₹ 4,400 (i.e., ₹ 1,400 + ₹ 3,000), which is less than the maximum permissible limit of ₹ 5,000.

Question 5

The following are the particulars relating to Mr.A, Mr.B, Mr.C and Mr.D, salaried individuals, for A.Y.2020-21 –

Particulars	Mr. A	Mr. B	Mr. C	Mr. D
Amount of loan taken	₹ 43 lakhs	₹ 45 lakhs	₹ 20 lakhs	₹ 15 lakhs
Loan taken from	HFC	Deposit taking NBFC	Deposit taking NBFC	Public sector bank
Date of sanction of loan	1.4.2019	1.4.2019	1.4.2019	30.3.2019
Date of disbursement of loan	1.5.2019	1.5.2019	1.5.2019	1.5.2019
Purpose of loan	Acquisition of residential house property for self-occupation	Acquisition of residential house property for self-occupation	Purchase of electric vehicle for personal use	Purchase of electric vehicle for personal use
Stamp duty value of house property	₹ 45 lakhs	₹ 48 lakhs	-	-
Cost of electric vehicle	-	-	₹ 22 lakhs	₹ 18 lakhs
Rate of interest	9% p.a.	9% p.a.	10% p.a.	10% p.a.

Compute the amount of deduction, if any, allowable under the provisions of the Income-tax Act, 1961 for A.Y.2020-21 in the hands of Mr. A, Mr. B, Mr. C and Mr. D. Assume that there has been no principal repayment during the P.Y.2019-20.

Answer

Particulars	₹
Mr. A	
Interest deduction for A.Y.2020-21	
(i) Deduction allowable while computing income under the head "Income from house property"	
Deduction u/s 24(b) ₹ 3,54,750 [₹ 43,00,000 × 9% x 11/12]	
Restricted to	2,00,000
(ii) Deduction under Chapter VI-A from Gross Total Income	
Deduction u/s 80EEA ₹ 1,54,750 (₹ 3,54,750 – ₹ 2,00,000)	
Restricted to	1,50,000
Mr. B	
Interest deduction for A.Y.2020-21	
(i) Deduction allowable while computing income under the head "Income from house property"	
Deduction u/s 24(b) ₹ 3,71,250 [₹ 45,00,000 × 9% x 11/12]	

Restricted to	2,00,000
(ii) Deduction under Chapter VI-A	
Deduction u/s 80EEA is not permissible since: (i) loan is taken from NBFC (ii) stamp duty value exceeds ₹ 45 lakh. Deduction under section 80EEA would not be permissible due to either violation listed above.	Nil
Mr. C	
Deduction under Chapter VI-A	
Deduction u/s 80EEB for interest payable on loan taken for purchase of electric vehicle [₹ 20 lakhs x 10% x 11/12 = ₹ 1,83,333, restricted to ₹ 1,50,000, being the maximum permissible deduction]	1,50,000
Mr. D	
Deduction under Chapter VI-A	
Deduction u/s 80EEB is not permissible since loan was not sanctioned in the P.Y.2019-20.	Nil

Question 6

Mr. Shiva aged 58 years, has gross total income of ₹ 7,75,000 comprising of income from salary and house property. He has made the following payments and investments:

(i) Premium paid to insure the life of her major daughter (policy taken on 1.4.2017) (Assured value ₹ 1,80,000) – ₹ 20,000

(ii) Medical Insurance premium for self – ₹ 12,000; Spouse – ₹ 14,000

(iii) Donation to a public charitable institution registered under 80G ₹ 50,000 by way of cheque

(iv) LIC Pension Fund – ₹ 60,000

(v) Donation to National Children's Fund - ₹ 25,000 by way of cheque

(vi) Donation to Jawaharlal Nehru Memorial Fund - ₹ 25,000 by way of cheque

(vii) Donation to approved institution for promotion of family planning - ₹ 40,000 by way of cheque

(viii) Deposit in PPF - ₹ 1,00,000

Compute the total income of Mr. Shiva for A.Y. 2020-21.

Answer

Computation of Total Income of Mr. Shiva for A.Y. 2020-21

Particulars	₹	₹
Gross Total Income		**7,75,000**
Less: Deduction under section 80C		
Deposit in PPF	1,00,000	
Life insurance premium paid for insurance of major daughter (Maximum 10% of the assured value ₹ 1,80,000, as the policy is taken after 31.3.2012)	18,000	
	1,18,000	
Deduction u/s 80CCC in respect of LIC pension fund	60,000	

	1,78,000	
As per section 80CCE, deduction u/s 80C & 80CCC is restricted to		1,50,000
Deduction under section 80D		
Medical Insurance premium in respect of self and spouse	26,000	
Restricted to		25,000
Deduction under section 80G (See Working Note below)		87,500
Total income		**5,12,500**

Working Note: Computation of deduction under section 80G

	Particulars of donation	Amount donated (₹)	% of deduction	Deduction u/s 80G (₹)
(i)	National Children's Fund	25,000	100%	25,000
(ii)	Jawaharlal Nehru Memorial Fund	25,000	50%	12,500
(iii)	Approved institution for promotion of family planning	40,000	100%, subject to qualifying limit	40,000
(iv)	Public Charitable Trust	1,50,000	50% subject to qualifying limit (See Note below)	10,000
				87,500

Note - Adjusted total income = Gross Total Income – Amount of deductions under section 80C to 80U except section 80G i.e., ₹ 6,00,000, in this case.

₹ 60,000, being 10% of adjusted total income is the qualifying limit, in this case.

Firstly, donation of ₹ 40,000 to approved institution for family planning qualifying for 100% deduction subject to qualifying limit, has to be adjusted against this amount. Thereafter, donation to public charitable trust qualifying for 50% deduction, subject to qualifying limit is adjusted. Hence, the contribution of ₹ 50,000 to public charitable trust is restricted to ₹ 20,000 (being, ₹ 60,000 - ₹ 40,000), 50% of which would be the deduction under section 80G. Therefore, the deduction under section 80G in respect of donation to public charitable trust would be ₹10,000, which is 50% of ₹ 20,000.

Question 7

A (P) Ltd. was incorporated on 1.4.2017 and it holds a certificate of eligible business from the notified IMBC[4]. It is engaged in innovation of new products. Its total turnover and profits and gains from such business for the P.Y.2017-18 to P.Y.2023-24 are as follows:

Particulars	P.Y. 2017-18	P.Y. 2018-19	P.Y. 2019-20	P.Y. 2020-21	P.Y. 2021-22	P.Y. 2022-23	P.Y. 2023-24
	(₹ in crores)						
Total turnover	15.42	18.36	20.21	22.72	24.95	23.52	24.68
Profits/Losses	(2.52)	(1.37)	6.52	8.13	9.87	7.59	9.42

Is A (P) Ltd. eligible for any tax benefit under the provisions of the Income-tax Act, 1961 for A.Y. 2020-21? If yes, what is the benefit available?

Answer

A (P) Ltd. is an eligible start-up, since –

(1) it is a company engaged in eligible business of innovation of new products.

(2) it is incorporated during the period 1.4.2016 to 31.3.2021.

(3) its total turnover does not exceed ₹ 25 crores in the relevant previous years for which deduction is claimed (i.e., P.Y.2019-20 to P.Y.2021-22 (or) P.Y.2020-21 to P.Y.2022-23 (or) P.Y.2021-22 to P.Y.2023-24)

(4) it holds a certificate of eligible business from the notified IMBC

Therefore, A (P) Ltd., being an eligible start-up, is eligible for deduction under section 80-IAC of 100% of the profits and gains derived by it from an eligible business for any three consecutive assessment years out of seven years beginning from the year in which the eligible start up is incorporated i.e., P.Y.2017-18.

In the first and second year i.e., P.Y.2017-18 and P.Y.2018-19, A (P) Ltd. has incurred a loss. In the current previous year i.e., P.Y.2019-20, A (P) Ltd. has earned profits from eligible business and can hence, claim 100% of its profits as deduction for any three consecutive assessment years under section 80-IAC from the P.Y.2019-20 to P.Y.2023-24. However, for P.Y.2019-20, the profits eligible for deduction would be the profits after set-off of brought forward losses of P.Y.2017-18 and P.Y. 2018-19.

Question 8

Mr. A has commenced the business of manufacture of computers on 1.4.2019. He employed 350 new employees during the P.Y.2019-20, the details of whom are as follows –

	No. of employees	Date of employment	Regular/ Casual	Total monthly emoluments per employee (₹)
(i)	75	1.4.2019	Regular	24,000
(ii)	125	1.5.2019	Regular	26,000
(iii)	50	1.8.2019	Casual	25,500
(iv)	100	1.9.2019	Regular	24,000

The regular employees participate in recognized provident fund while the casual employees do not. Compute the deduction, if any, available to Mr. A for A.Y.2020-21, if the profits and gains derived from manufacture of computers that year is ₹ 75 lakhs and his total turnover is ₹ 2.16 crores.

What would be your answer if Mr. A has commenced the business of manufacture of footwear on 1.4.2019?

Answer

Mr. A is eligible for deduction under section 80JJAA since he is subject to tax audit under section 44AB for A.Y.2020-21, as his total turnover from business exceeds ₹ 1 crore and he has employed "additional employees" during the P.Y.2019-20.

I **<u>If Mr. A is engaged in the business of manufacture of computers</u>**

Additional employee cost = ₹ 24,000 × 12 × 75 **[See Working Note below]** = ₹ 2,16,00,000

Deduction under section 80JJAA = 30% of ₹ 2,16,00,000 = ₹ 64,80,000.

<u>Working Note:</u>

Number of additional employees

Particulars	No. of workmen	
Total number of employees employed during the year		350

Less:	Casual employees employed on 1.8.2019 who do not participate in recognized provident fund	50	
	Regular employees employed on 1.5.2019, since their total monthly emoluments exceed ₹ 25,000	125	
	Regular employees employed on 1.9.2019 since they have been employed for less than 240 days in the P.Y.2019-20.	100	275
Number of "additional employees"			**75**

Notes –

(i) Since casual employees do not participate in recognized provident fund, they do not qualify as additional employees. Further, 125 regular employees employed on 1.5.2019 also do not qualify as additional employees since their monthly emoluments exceed ₹ 25,000. Also, 100 regular employees employed on 1.9.2019 do not qualify as additional employees for the P.Y.2019-20, since they are employed for less than 240 days in that year.

Therefore, only 75 employees employed on 1.4.2019 qualify as additional employees, and the total emoluments paid or payable to them during the P.Y.2019-20 is deemed to be the additional employee cost.

(ii) As regards 100 regular employees employed on 1.9.2019, they would be treated as additional employees for previous year 2020-21, if they continue to be employees in that year for a minimum period of 240 days. Accordingly, 30% of additional employee cost in respect of such employees would be allowable as deduction under section 80JJAA in the hands of Mr. A for the A.Y. 2021-22.

II **<u>If Mr. A is engaged in the business of manufacture of footwear</u>**

If Mr. A is engaged in the business of manufacture of footwear, then, he would be entitled to deduction under section 80JJAA in respect of employee cost of regular employees employed on 1.9.2019, since they have been employed for more than 150 days in the previous year 2019-20.

Additional employee cost = ₹ 2,16,00,000 + ₹ 24,000 × 7 × 100 = ₹ 3,84,00,000 Deduction under section 80JJAA = 30% of ₹ 3,84,00,000 = ₹ 1,15,20,000

Question 9

Mr. A, a resident individual aged about 61 years, has earned business income (computed) of ₹ 1,35,000, lottery income of ₹ 1,20,000 (gross) during the P.Y. 2019-20. He also has interest on Fixed Deposit of ₹ 30,000 with banks. He invested an amount of ₹ 1,50,000 in Public Provident Fund account. What is the total income of Mr. A for the A.Y.2020-21?

Answer

Computation of total income of Mr. A for A.Y.2020-21

Particulars	₹	₹
Profits and gains of business or profession		1,35,000
Income from other sources		
- Interest on Fixed Deposit with banks		30,000
- lottery income		1,20,000
Gross Total Income		**2,85,000**
Less: Deductions under Chapter VIA **[See Note below]**		

Under section 80C		
- Deposit in Public Provident Fund	1,50,000	
Under section 80TTB		
- Interest on fixed deposits with banks	30,000	
	1,80,000	
Restricted to		1,65,000
Total Income		**1,20,000**

Note: In case of resident individuals of the age of 60 years or more, interest on bank fixed deposits qualifies for deduction upto ₹ 50,000 under section 80TTB.

Though the value of eligible deductions is ₹ 1,80,000, however, deduction under Chapter VI-A cannot exceed the gross total income exclusive of long term capital gains taxable under section 112 and section 112A, short-term capital gains covered under section 111A and winnings of lotteries of the assessee.

Therefore, the maximum permissible deduction under Chapter VI-A = ₹ 2,85,000 – ₹ 1,20,000 = ₹ 1,65,000.

Question 10

Mr. Gurnam, aged 42 years, has salary income (computed) of ₹ 5,50,000 for the previous year ended 31.03.2020. He has earned interest of ₹ 14,500 on the saving bank account with State Bank of India during the year. Compute the total income of Mr. Gurnam for the assessment year 2020-21 from the following particulars:

(i) Life insurance premium paid to Birla Sunlife Insurance in cash amounting to ₹ 25,000 for insurance of life of his dependant parents. The insurance policy was taken on 15.07.2017 and the sum assured on life of his dependant parents is ₹ 2,00,000.

(ii) Life insurance premium of ₹ 25,500 paid for the insurance of life of his major son who is not dependant on him. The sum assured on life of his son is ₹ 2,50,000 and the life insurance policy was taken on 30.3.2012.

(iii) Life insurance premium paid by cheque of ₹ 22,500 for insurance of his life. The insurance policy was taken on 08.09.2016 and the sum assured is ₹ 2,00,000.

(iv) Premium of ₹ 26,000 paid by cheque for health insurance of self and his wife.

(v) ₹ 1,500 paid in cash for his health check-up and ₹ 4,500 paid in cheque for health check-up for his parents, who are senior citizens.

(vi) Paid interest of ₹ 6,500 on loan taken from bank for MBA course pursued by his daughter.

(vii) A sum of ₹ 15,000 donated in cash to an institution approved for purpose of section 80G for promoting family planning.

Answer

Computation of total income of Mr. Gurnam for the Assessment Year 2020-21

Particulars	₹	₹	₹
Income from salary			5,50,000
Interest on saving bank deposit			14,500
Gross Total Income			**5,64,500**
Less: **Deduction under Chapter VI-A**			
Under section 80C (See Note 1)			

Life insurance premium paid for life insurance of:			
- major son	25,500		
- self ₹ 22,500 restricted to 10% of ₹ 2,00,000	20,000	45,500	
Under section 80D (See Note 2)			
Premium paid for ₹ 26,000 health insurance of self and wife by cheque, restricted to	25,000		
Payment made for health check-up for parents:	4,500	29,500	
Under section 80E			
For payment of interest on loan taken from bank for MBA course of his daughter		6,500	
Under section 80TTA (See Note 4)			
Interest on savings bank account ₹ 14,500 restricted to		10,000	91,500
Total Income			**4,73,000**

Notes:

(1) As per section 80C, no deduction is allowed in respect of premium paid for life insurance of parents whether they are dependant or not. Therefore, no deduction is allowable in respect of ₹ 25,000 paid as premium for life insurance of dependant parents of Mr. Gurnam.

In respect of insurance policy issued on or after 01.04.2012, deduction shall be allowed for life insurance premium paid only to the extent of 10% of sum assured. In case the insurance policy is issued before 01.04.2012, deduction of premium paid on life insurance policy shall be allowed up to 20% of sum assured.

Therefore, in the present case, deduction of ₹ 25,500 is allowable in respect of life insurance of Mr. Gurnam's son since the insurance policy was issued before 01.04.2012 and the premium amount is less than 20% of ₹ 2,50,000. However, in respect of premium paid for life insurance policy of Mr. Gurnam himself, deduction is allowable only up to 10% of ₹ 2,00,000 since the policy was issued after 01.04.2012 and the premium amount exceeds 10% of sum assured.

(2) As per section 80D, in case the premium is paid in respect of health of a person specified therein and for health check-up of such person, deduction shall be allowed up to ₹ 25,000. Further, deduction up to ₹ 5,000 in aggregate shall be allowed in respect of health check-up of self, spouse, children and parents. In order to claim deduction under section 80D, the payment for health-checkup can be made in any mode including cash. However, the payment for health insurance premium has to be paid in any mode other than cash.

Therefore, in the present case, in respect of premium of ₹ 26,000 paid for health insurance of self and wife, deduction would be restricted to ₹ 25,000. Since the limit of ₹ 25,000 has been exhausted against medical insurance premium, no deduction is allowable for preventive health check-up for self and wife. However, deduction of ₹ 4,500 is allowable in respect of health check-up of his parents, since it falls within the limit of ₹ 5,000.

(3) No deduction shall be allowed under section 80G in case the donation is made in cash of a sum exceeding ₹ 2,000. Therefore, deduction under section 80G is not allowable in respect of **cash donation** of ₹ 15,000 made to an institution approved for the purpose of section 80G for promotion of family planning.

(4) As per section 80TTA, deduction shall be allowed from the gross total income of an individual or Hindu Undivided Family in respect of income by way of interest on deposit in the savings

account included in the assessee's gross total income, subject to a maximum of ₹ 10,000. Therefore, a deduction of ₹ 10,000 is allowable from the gross total income of Mr. Gurnam, though the interest from savings bank account is ₹ 14,500.

Question 11

Mr. Srinivasan, aged 61 years, furnishes the following particulars for the year ending 31.03.2020:

(a) Life Insurance Premium paid – ₹ 15,000, actual capital sum of the policy assured for ₹ 1,40,000. The insurance policy was taken on 31.03.2012;

(b) Contribution to Public Provident Fund – ₹ 40,000 in the name of father;

(c) Tuition fee payment – ₹ 8,000 each for 2 sons pursuing full time graduation course in Calcutta; Tuition fee for daughter pursuing PHD in Kellogg University, USA – ₹ 2.50 Lacs;

(d) Housing loan principal repayment – ₹ 32,000 to Axis Bank. This property is under construction at Calcutta as on 31.03.2020;

(e) Principal repayment of housing loan taken from a relative – ₹ 70,000. The property is self-occupied situated at Pune;

(f) Deposit under Senior Citizens Savings Scheme – ₹ 15,000;

(g) Five-year deposits in an account under Post Office Time Deposit Scheme – ₹ 50,000;

(h) Investment in National Savings Certificate – ₹ 70,000;

Compute the deduction eligible under appropriate provisions of section 80C for A.Y. 2020-21.

Answer

Computation of eligible deduction under section 80C for A.Y.2020-21

Particulars	₹
Life Insurance Premium **(See Note 1)**	15,000
Contribution to Public Provident fund **(See Note 2)**	Nil
Tuition fee of 2 sons for graduation course **(See Note 3)**	16,000
Housing loan principal repayment **(See Notes 4 & 5)**	Nil
Senior Citizen Savings Scheme deposit **(See Note 6)**	15,000
Post Office Time Deposit Scheme **(See Note 6)**	50,000
Investment in National Savings Certificate	70,000
Total Investment	**1,66,000**
Eligible deduction under section 80C restricted to	1,50,000

Notes:

1. Any amount of life insurance premium paid in excess of the specified percentage of actual capital sum assured shall be ignored for the purpose of deduction under section 80C. In the given case, since the insurance policy has been issued before 1.04.2012, therefore, premium paid upto 20% of actual capital sum assured i.e., ₹ 28,000 shall be allowed as deduction. Hence, the premium of ₹ 15,000 paid during the year is allowable as deduction under section 80C.

2. In the case of an individual, contribution to PPF can be made in his name or in the name of his spouse or children to qualify for deduction under section 80C. **As the contribution was made in the name of his father, deduction is not allowable.**

3. Tuition fee paid is eligible for deduction under section 80C for a maximum of two children. Therefore, ₹ 16,000 shall be allowed as deduction. **Tuition fee paid to an educational institution situated outside India is not eligible for deduction.**

4. In order to claim the principal repayment on loan borrowed for house property as deduction, the construction of such property should have been completed and should be chargeable to tax under the head "Income from house property". In the given case, since the property is under construction, principal repayment does not qualify for deduction.

5. Repayment of principal on housing loan is not allowed as deduction in case the loan is borrowed from friends, relatives etc. In order to qualify for deduction, the loan should have been obtained from Central Government / State Government / bank / specified employer / institution.

6. The following investments are also eligible for deduction under section 80C:-
   (1) five year time deposit in an account under Post Office Time Deposit Rules, 1981; and
   (2) deposit in an account under the Senior Citizens Savings Scheme Rules, 2004.

Question 12

X Ltd. has two units, unit 'N' and unit 'Y'. Unit 'N' engaged in the business of power generation installed a windmill in March, 2018 and had a profit of ₹ 100 lakhs in Assessment Year 2020-21. X Ltd. claimed depreciation of ₹ 120 lakhs on windmill against the profit of ₹ 100 lakhs from power generation business which was eligible for deduction under section 80-IA. Unit 'Y', engaged in manufacturing of wires, non-eligible business, had a profit of ₹ 70 lakhs for Assessment Year 2020-21.

The loss of ₹ 20 lakhs, i.e., balance depreciation not set off pertaining to unit 'N' was set-off against the profits of unit 'Y' carrying on non-eligible business, by the assessee, X Ltd. The Assessing Officer was of the view that depreciation relating to a business eligible for deduction under section 80-IA cannot be set-off against non-eligible business income. Hence, unabsorbed depreciation should be carried forward to the subsequent year to be set off against eligible business income of the assessee of that year.

Examine the correctness of the action of the Assessing Officer.

Answer

In CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245, the Karnataka High Court observed that it is a generally accepted principle that the deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1).

In this case, X Ltd. had incurred loss in eligible business (power generation) on account of claiming depreciation of ₹ 120 lakhs. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed.

It is, thereafter, that section 70(1) comes into play, whereby an assessee is entitled to set off the losses from one source against income from another source under the same head of income. Accordingly, X Ltd. is entitled to the benefit of set off of loss of ₹ 20 lakhs (representing balance depreciation not set-off) pertaining to Unit N engaged in eligible business of power generation against profit of ₹ 70 lakhs of Unit Y carrying on non-eligible business. Therefore, the net profit of ₹ 50 lakhs would be taxable in the A.Y.2020-21.

However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e.,

the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year. Accordingly, in the A.Y.2021-22, the net profits of Unit N has to be reduced by ₹ 20 lacs for computing the profits eligible for deduction under section 80-IA in that year.

The action of the Assessing Officer in not permitting set-off of loss of eligible business against profits of non-eligible business in this case is, therefore, not correct.

Question 13

From the following details, compute the total income of Mr. A, Mr. B and Mr. C for A.Y.2020-21 –

Particulars		Mr. A	Mr. B	Mr. C
		₹	₹	₹
(i)	Salary (computed)	9,25,000	10,45,000	11,15,000
(ii)	Interest income (on fixed deposits)	75,000	85,000	95,000

The particulars of their other investments/ payments made during the P.Y.2019-20 are given hereunder –

	Particulars	₹
(1)	Deposit in Public Provident Fund (PPF) by Mr. A	1,50,000
(2)	Life insurance premium paid by Mr. C, the details of which are as follows –	
	Date of policy / Person insured / Actual capital sum assured (₹) / Insurance issue of premium paid during 2019-20 (₹)	
	31/3/2012 Self 1,48,000 15,000	
	11/6/2016 Spouse 1,25,000 15,000	
	31/7/2017 Handicapped son (Section 80U disability) 2,00,000 32,000	
(3)	**Payment of medical insurance premium by the following persons to insure their health:**	
	Payer / Amount in ₹ / Mode of payment	
	Mr. A (aged 55 years) 30,000 Account payee cheque	
	Mr. B (aged 52 years) 15,000 Cash	
	Mr. C (aged 48 years) 20,000 Crossed cheque	
(4)	Mr. B paid interest on loan taken for the purchase of house in which he currently resides. He is claiming benefit of self-occupation under section 23(2) in respect of this house. He does not own any other house.	2,20,000
(5)	Repayment of principal amount of loan taken for purchase of the said house	1,70,000 30,000
(6)	Contribution by Mr. A by cheque to National Children's Fund during the year. Mr. B makes the following donations during the P.Y.2019-20 -	
	Donation to BJP by crossed cheque	50,000 50,000

	Donation to Electoral trust by cash

Answer

Computation of total income for A.Y.2020-21

	Particulars	Mr. A	Mr. B	Mr. C
		₹	₹	₹
	Salary	9,25,000	10,45,000	11,15,000
	Income from house property **[See Note 4]**		(2,00,000)	
	Income from other sources (Interest)	75,000	85,000	95,000
(A)	**Gross total income**	**10,00,000**	**9,30,000**	**12,10,000**
	Less: Deductions under Chapter VIA			
	Under section 80C			
	Deposit in PPF **[See Note 3]**	1,50,000		
	LIC premium paid **[See Note 1]**			57,500
	Principal repayment of housing loan (restricted to ₹ 1,50,000) **[See Note 4]**		1,50,000	
	Under section 80D			
	Medical insurance premium **[See Note 2]**	25,000	Nil	20,000
	Under section 80G			
	Contribution to National Children's Fund **[See Note 5]**	30,000		
	Under section 80GGC [See Note 6]			
	Donation to BJP by crossed cheque		50,000	
	Cash donation to Electoral Trust		Nil	
(B)	**Total deduction under Chapter VIA**	**2,05,000**	**2,00,000**	**77,500**
(C)	**Total Income (A) – (B)**	**7,95,000**	**7,30,000**	**11,32,500**

Notes:

(1) Deduction u/s 80C in respect of life insurance premium paid by Mr. C

Date of issue of policy	Person insured	Actual capital sum assured	Insurance premium Paid during 2019-20	Restricted to % of sum assured	Deduction u/s 80C
31/3/2012	Self	1,48,000	15,000	20%	15,000
11/6/2016	Spouse	1,25,000	15,000	10%	12,500
31/7/2017	Handicapped Son (section 80U disability)	2,00,000	32,000	15%	30,000
				Total	**57,500**

(2)	**Medical Insurance Premium** (i) Medical insurance premium of ₹ 30,000 paid by account payee cheque by Mr. A is allowed as a deduction under section 80D, subject to a maximum of ₹ 25,000. (ii) Medical insurance premium paid by cash is not allowable as deduction. Hence, Mr. B is not eligible for deduction under section 80D in respect of medical insurance premium of ₹ 15,000 paid in cash. (iii) Mr. C is eligible for deduction of ₹ 20,000 under section 80D in respect of medical insurance premium paid by crossed cheque.
(3)	The maximum amount eligible for deduction under section 80C shall not exceed ₹ 1,50,000. Mr. A would be eligible for deduction of ₹ 1,50,000 in respect of PPF under section 80C.
(4)	**Deduction in respect of interest and principal repayment of housing loan** Mr. B is eligible for a maximum deduction of ₹ 2,00,000 under section 24 in respect of interest on housing loan taken in respect of a self-occupied property, for which he is claiming benefit of "Nil" annual value. Therefore, ₹ 2,00,000 would represent his loss from house property. Further, the maximum amount eligible for deduction under section 80C should not exceed ₹ 1,50,000. Since, Mr. B has no other investment under section 80C during the previous year 2019-20, he would be eligible for deduction of ₹ 1,50,000 in respect of principal repayment of housing loan.
(5)	Contribution to National Children's Fund qualifies for 100% deduction under section 80G. Therefore, Mr. A is entitled to 100% deduction of the sum of ₹ 30,000 contributed by him by way of cheque to National Children's Fund.
(6)	Mr. B is eligible for deduction under section 80GGC in respect of donation to a political party made otherwise than by way of cash. However, cash donations to electoral trust do not qualify for deduction under section 80GGC.

Question 14

Following issues have been raised by Navi Limited in connection with its eligibility for claiming deduction under section 80-IB for your consideration and advice for the assessment year 2020-21:

(i) It operates two separate industrial units. One unit is eligible for deduction under section 80-IB, while the other unit is not eligible for such deduction. If the eligible unit has profit and the other unit has loss, should it claim deduction after setting off the loss of the other unit against profit of the eligible unit?

(ii) Its profit from one unit includes sale of import entitlement, duty drawback and interest from customers for delayed payment. Is it permissible to claim deduction on these items of income?

Answer

(i) Section 80-IB(13) provides that the provisions contained in section 80-IA(5) shall, so far as may be, apply to the eligible business under section 80-IB. Accordingly, for the purpose of computing the deduction under section 80-IB, the profits and gains of an eligible business shall be computed as if such eligible business was the only source of income of the assessee.

Therefore, Navi Limited should claim deduction under section 80-IB on profit from the eligible unit without setting off loss suffered in the other unit. It may be noted that the aggregate deduction under Chapter VI-A, however, cannot exceed the gross total income of the assessee.

(ii) Under section 80-IB, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking referred to in the section, there shall be

allowed, in computing the total income of the assessee, a deduction from such profits and gains at the specified percentage and for such number of years as specified in the section. In CIT vs. Sterling Foods (1999) 237 ITR 579 (SC) and Liberty India vs. CIT (2009) 317 ITR 218 (SC), it was held that sale of import entitlement and duty drawback cannot be construed as income derived from industrial undertaking. Therefore, such income cannot be included in computing income for the purpose of deduction under section 80-IB.

Interest income derived by an undertaking on delayed collection of sale proceeds shall be treated as income derived from the industrial undertaking, and therefore, the same would be eligible for deduction under section 80-IB. [Phatela Cotgin Industries Private Limited vs CIT (2008) 303 ITR 411 (P & H)].

Question 15

PQR Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities, has received the following amounts during the year ending 31.3.2020:

(i) Interest amounting to ₹ 1,00,000 from its members on loans advanced to them.

(ii) Interest amounting to ₹ 1,50,000 on deposits with other co-operative societies.

(iii) Rent amounting to ₹ 2,00,000 from letting out its godowns for storage of commodities.

PQR Co-operative Bank seeks your advice in the matter of taxability of the above amounts and the eligibility for deduction, if any, in respect thereof for the assessment year 2020-21.

Answer

Sub-clause (viia) to section 2(24) includes within the scope of definition of income, the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members. Hence, the interest of ₹ 1,00,000 received by PQR Co-operative Bank on loans advanced to its members constitutes its income.

Further, interest received amounting to ₹ 1,50,000 on deposits with other co-operative societies and rent amounting to ₹ 2,00,000 received from letting out its godowns for storage of commodities also constitute the income of the co-operative bank.

Sub-section (4) of section 80P provides that section 80P shall not apply to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Explanation to section 80P(4) defines a primary co-operative agricultural and rural development bank to mean a society having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities.

PQR Co-operative Bank is a primary co-operative agricultural and rural development bank as defined in the said Explanation since it is a co-operative society having its area of operation confined to Gubbi Taluk and its principal object is to provide long-term credit for agricultural and rural development activities. Therefore, it is eligible for deduction under section 80P.

Interest of ₹ 1,00,000 received by the bank on loans advanced to its members is eligible for deduction in full under section 80P(2)(a)(i).

Interest of ₹ 1,50,000 received by the bank from deposits with other co-operative societies qualifies for deduction in full under section 80P(2)(d).

Rent of ₹ 2,00,000 received by the bank from letting out its godowns for storage of commodities is eligible for deduction in full under section 80P(2)(e).

Section B – Additional Questions

Question 16

Mr. K, a resident, aged 63 years, has the following income during the previous year 2019-20:
- Salary Income(net) ₹ 6,80,000
- Interest on savings bank account with Allahabad Bank ₹ 16,000

Other particulars given by Mr. K are as under:

(i) Insurance premium paid to Max Life Insurance Ltd. amounting to ₹ 25,000 under a policy taken on life of his son. The policy was taken on 20th July, 2011 and the sum assured is ₹ 1,80,000.

(ii) Insurance premium paid to Life Insurance Corporation of India amounting to ₹ 22,000 under a policy taken on his life on 20th April, 2012 and the sum assured is ₹ 2,00,000.

(iii) Premium of ₹ 28,000 paid by cheque on health insurance for self to National Insurance Corporation Ltd. and payment in cash of ₹ 5,000 to a hospital for preventive health check-up for self.

Compute the total income of Mr. K for A.Y. 2020-21 on the basis of the above particulars.

Answer

Computation of total income of Mr. K for the A.Y.2020-21

Particulars		₹	₹
Income from salaries			6,80,000
Income from Other Sources (Interest on savings bank account)			16,000
Gross Total Income			6,96,000
***Less*: Deductions under Chapter VI-A**			
Under section 80C (Life insurance premium paid)			
Premium paid in respect of policy taken on life of son (See Note 1 below)	25,000		
Premium paid in respect of policy taken on own life (See Note 2 below)	20,000		
		45,000	
Under section 80D (Medical insurance premium paid) (See Note 3 below)		33,000	
Under section 80TTB (Interest on savings bank account) (See Note 4 below)		16,000	94,000
Total Income			**6,02,000**

Notes:

(1) Mr. K can claim deduction under section 80C in respect of insurance premium paid by him in respect of a policy taken on the life of his son. Since the policy was issued before 1.4.2012, the premium paid shall be allowed as deduction upto 20% of sum assured (i.e., upto ₹ 36,000, being 20% of ₹ 1,80,000). Since the insurance premium of ₹ 25,000 paid is within this limit, the same is fully allowable as deduction under section 80C.

(2) In respect of premium of ₹ 22,000 paid by Mr. K to LIC under an insurance policy taken on his own life, the deduction under section 80C would be restricted to 10% of sum assured, since the premium is paid in respect of a life insurance policy taken on or after

1.4.2012. Therefore, the deduction under section 80C in respect of this policy would be restricted to ₹ 20,000, being 10% of ₹ 2,00,000.

(3) Deduction under section 80D is allowable in respect of health insurance premium paid by any mode other than cash and expenses on preventive health check-up (upto ₹ 5,000) paid by any mode, including cash. Therefore, both the premium of ₹ 28,000 paid by cheque and preventive health check-up of ₹ 5,000 paid by cash qualifies for deduction under section 80D. However, the deduction would be restricted to ₹ 50,000, which is the overall limit under section 80D in respect of a resident individual, who is of the age of 60 years or more at any time during the previous year.

(4) As per section 80TTB, deduction shall be allowed from the gross total income of an individual in respect of income by way of deposit in the savings bank account included in the assessee‟s gross total income, subject to a maximum of ₹ 50,000.

Question 17

Ms. Madhvi, a resident individual and self-employed industrial designer, furnished the following particulars for the year ended 31-03-2020:

	Particulars	₹
i.	Gross total income	5,00,000
ii.	Housing loan principal repayment. The property is under construction at Jaipur as on 31-03-2020	1,10,000
iii.	Principal repayment of housing loan from a relative. This property is self- occupied situated at Jodhpur.	50,000
iv	Contribution to Public Provident Fund in the name of her mother.	70,00,000
v	She deposited ₹ 5,000 per month in her account under a pension scheme notified by the Central Government.	

Compute total income of Ms. Madhvi for the Assessment Year 2020-21 stating reasons for the deduction eligible under appropriate provisions of Chapter VI-A.

Answer

Computation of total income of Ms. Madhvi for the A.Y. 2020-21

Particulars	₹	₹
Gross Total Income		5,00,000
***Less:* Deductions under Chapter VI-A Section**		
80C		
Principal repayment for housing loan taken for house property at Jaipur **[See Note 1]**	**Nil**	
Principal repayment for housing loan taken for house property at Jodhpur **[See Note 2]**	**Nil**	
Contribution to public provident fund in the name of mother **[See Note 3]**	**Nil**	
Section 80CCD		
Contribution to pension scheme notified by the Central Government **[See Note 4]**	60,000	
		60,000
Total income		**4,40,000**

Notes :

(1) As per the provisions of section 80C, the deduction for principal repayment of housing loan is provided only in respect of a house property whose income is chargeable to tax under the head „Income from house property". As the house property at Jaipur is still under construction, no income is chargeable to tax under the head "Income from house property". Hence, no deduction would be available under section 80C for principal repayment of the housing loan for property under construction at Jaipur.

(2) The deduction for principal repayment of housing loan under section 80C is provided only in respect of the loan taken from the institutions mentioned under section 80C (like banks, Life Insurance Corporation of India, National Housing Bank, specified employer etc.) However, loan from a relative does not qualify for deduction under section 80C. Since, in the present case, the loan is taken from a relative, no deduction would be available under section 80C for the repayment of the principal in respect of self -occupied property at Jodhpur.

(3) The contribution to public provident fund is allowed as deduction only if it is in the name of specified persons mentioned in section 80C, namely, self, spouse or any child of such individual. Since mother of the individual is not a specified person as per section 80C, no deduction would be available for the contribution to public provident fund in the name of the mother.

(4) The deduction under section 80CCD(1) shall be an amount not exceeding 10% of the gross total income of in case of a self-employed individual. Therefore, the deduction in respect of deposit by Ms. Madhvi to the pension scheme notified by the Central Government ₹ 60,000 shall be limited to ₹ 50,000, being 10% of ₹ 5,00,000, under section 80CCD(1). Thereafter, the balance ₹ 10,000 can be claimed as deduction under section 80CCD(1B). It may be noted that deduction of upto ₹ 50,000 under section 80CCD(1B) is over and above the deduction under section 80CCD(1). Deduction under section 80CCD(1B) is not subject to the overall limit of ₹ 1,50,000 under section 80CCE.

Question 18

Mr. Sarthak a software engineer wants to commence a business in manufacture of solar powered car. He provides the following information:

(i) The project cost is estimated at ₹ 5 crores.

(ii) He has a residential house in Surat since 2010 which could be sold for ₹ 3 crores.

(iii) And the balance ₹ 2 crores could be financed through bank borrowings at a cost of 13% per annum.

(iv) He has another option viz. his friend Miss Juhi who is willing to contribute ₹ 2 crores and become a co-promoter.

The indexed cost of acquisition of the residential house (Computed) is ₹ 70 lakhs.

Mr. Sarthak seeks your guidance on the project finance taking into account any tax incentives available under Income Tax Law besides the funding of project through bank finance or accepting Miss Juhi as Co-promoter.

You are requested to advise Mr. Sarthak, on Income tax aspects to avail tax benefits within the four corners of law.

Answer

Under section 80-IAC, where the gross total income of an eligible start-up includes any profits and gains derived from eligible business, a deduction of 100% of the profits and gains derived from such business would be available for any 3 consecutive assessment years out of 7 consecutive assessment years, beginning from the previous year in which eligible start-up is incorporated.

Under section 54GB, the capital gains arising to an individual from transfer of his long- term capital asset, being a residential house, would be exempt if invests the net consideration in a company which is an eligible start-up carrying on eligible business under section 80-IAC.

In this case, the business of manufacture of a solar powered car falls within the meaning of eligible business, since it is driven by technology.

In order to avail the benefit of deduction under section 54GB, Mr. Sarthak must invest the net consideration of ₹ 3 crores on transfer of long-term capital asset, being his residential house in Surat, in an eligible start up, by setting up a new company before 1.4.2019 and subscribing to the equity shares of the company.

The start-up company formed to carry on the business of manufacture of solar powered car would be an eligible start-up which is technology driven, if it obtains a certificate of eligible business from IMBC and its turnover does not exceed ₹ 25 crores in any of the previous years upto P.Y.2020-21.

Mr. Sarthak should subscribe to more than 50% of the share capital of the company on or before the due date of filing of return of income under section 139(1) and the company should purchase new plant and machinery within one year from the date of subscription in equity shares by him.

If these conditions are fulfilled, the long-term capital gains of ₹ 2,30,00,000 [₹ 3,00,00,000 – ₹ 70,00,000] arising to Mr. Sarthak would not be chargeable to tax, since the entire net consideration of ₹ 3 crores has been utilised to subscribe to the shares of a company, being an eligible start up.

Furthermore, in any three consecutive assessment years out of seven consecutive assessment years, beginning from the previous year in which eligible start-up is incorporated, the company would be eligible to claim deduction of 100% of the profits and gains of business.

If the balance ₹ 2 crores is funded through bank borrowings, the interest payable would qualify for deduction under section 36 while computing the business income of the company, which would be beneficial in those years in which the company has not availed 100% deduction u/s 80-IAC.

On the other hand, if ₹ 2 crores is funded through subscription of shares by Miss Juhi, who would be a co-promoter, there would be sharing of both the risks and rewards with Miss Juhi. Since her shareholding would be only 40%, this arrangement will also not affect Mr. Sarthak's claim for deduction under section 54GB.

Question 19

ABC Ltd., a developer, is engaged in the business of developing of Special Economic Zones, notified on or after 1st April 2005 under the SEZ Act, 2005. It was established in the previous year 2014-15. It had exercised its option for claiming deduction under section 80-IAB from the Assessment Year 2017-18. It received the following incomes during the previous year 2019-20:

Income from the maintenance of SEZ	₹ 50,40,000
Income from lease rent from letting out of buildings along with other amenities in SEZ	₹ 14,25,000
Interest received from bank deposits (from the refundable security deposits received from lessees)	₹ 9,50,000

(1) Calculate the amount of deduction available to ABC Ltd. for the A.Y.2020-21.

(2) On 1st April, 2020, it transferred the operation and maintenance of the SEZ to another company, DEF Ltd. Now, DEF Ltd. wants to claim deduction under section 80-IAB in respect of the income derived from such maintenance of SEZ as was available for ABC Ltd. Comment whether the contention of DEF Ltd.· is valid in law.

Answer

Since ABC Ltd., a developer, is engaged in the business of developing an SEZ, notified on or after

1.4.2005, it is eligible for a deduction of 100% of profits and gains derived by it from any business of developing a SEZ for 10 consecutive assessment years out of 15 assessment years beginning from the year in which the SEZ has been notified by the Central Government.

ABC Ltd. has exercised its option for claiming deduction u/s 80-IAB from A.Y. 2017-18. Therefore, it is eligible to claim 100% deduction in the A.Y. 2020-21, being the 4th consecutive assessment year.

1) Amount of deduction available to ABC Ltd. for A.Y. 2020-21

Particulars	Amount in ₹
Income from the maintenance of SEZ	50,40,000
Income from lease rent from letting out of buildings along with other amenities in SEZ [As per CBDT Circular No. 16/2017 dated 25.04.2017, income from letting out of premises/developed space along with other facilities in an SEZ is taxable under 'PGBP".Hence, considered for deduction u/s 80-IAB]	14,25,000
Interest received from bank deposits [not taxable under 'PGBP". Hence, not considered for deduction u/s 80-IAB]	Nil
	64,65,000
Deduction u/s 80-IAB for A.Y. 2020-21 [100% of profits derived from business]	64,65,000

2) As per section 80-IAB, if an undertaking, being a Developer i.e., ABC Ltd., in the present case, who develops a SEZ on or after 1.4.2005, transfers the operation and maintenance of such SEZ to another Developer i.e., DEF Ltd., the deduction shall be allowed to DEF Ltd. for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the DEF Ltd.

Hence, DEF Ltd. can claim deduction u/s 80-IAB for the remaining period i.e., from A.Y.2021-22 to A.Y.2026-27.

CHAPTER - 12
Assessment of Various Entities

Section A – ICAI Study Material Questions

Question 1

A domestic company, ABC Ltd., furnishes the following particulars in respect of Assessment Year 2020-21 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.

(1)	Profits as per Statement of profit and loss as per the Companies Act, 2013		₹ 215 Lacs
(2)	Statement of Profit and Loss includes:		
	(a) Credits:	Dividend income from Indian companies	₹ 20 Lacs
		Excess realized on sale of land held as investment	₹ 30 Lacs
	(b) Debits:	Depreciation on straight line method basis	₹ 100 Lacs
		Provision for loss of subsidiary company	₹ 60 Lacs
(3)	Depreciation allowable as per the Income-tax Rules, 1962		₹ 150 Lacs
(4)	Short term Capital gains on sale of land mentioned above as computed under Income-tax Act, 1961		₹ 40 Lacs
(5)	Losses brought forward as per books of account and as per Income-tax Act, 1961:		
	Business loss		₹ 50 Lacs
	Unabsorbed depreciation		₹ 60 Lacs

The company has represented to you that the excess realized on sale of land cannot form part of the book profit for purposes of section 115JB. You will have to deal with this issue assuming that ABC Ltd. is not required to comply with the Indian Accounting Standards. Ignore the provisions of section 115BAA.

Note - The turnover of ABC Ltd. for the P.Y.2017-18 was ₹ 390 crore.

Answer

In the case of a company, it has been provided that where tax @15% on of book profit exceeds tax on total income computed as per normal provisions, the book profit shall be deemed to be the total income for tax purposes.

It is therefore necessary to compute total income as per Income-tax Act, 1961 as well as book profits.

I. Computation of Total income as per the Income-tax Act, 1961

Particulars	₹ (in Lacs)	
Net profit as per statement of profit and loss		215
Add: Depreciation debited to statement of profit and loss	100	
Provision for losses of subsidiary company	60	160
		375
Less: Dividend income – exempt under section 10(34)	20	
Excess realized on sale of land (considered separately)	30	
Depreciation allowable as per Income-tax Rules, 1962	150	200

Business Income		175
Less: Set-off of brought forward business loss		50
		125
Capital gains (Short term capital gains)		40
		165
Less: Set-off of unabsorbed depreciation		60
Total Income as per Income-tax Act, 1961		**105**

II. Computation of book profit under section 115JB

Particulars	**(₹ in Lacs)**	
Net profit as per statement of profit and loss		215
Add: Provision for loss of subsidiary		60
Depreciation		100
		375
Less: Dividend income exempt under section 10(34)	20	
Depreciation	100	
Business loss which is less than unabsorbed depreciation	50	170
"Book Profit"		**205**

Note: With regard to the company's representation, in respect of capital gain whether liable for book profit tax under section 115JB, it may be noted that since the excess realized on sale of land has been included in net profit computed under Schedule III of the Companies Act, 2013, it will form part of book profit [Bombay High Court judgment in CIT v. Veekay Lal Investment Co. Pvt. Ltd. (2001) 249 ITR 597].

Question 2

Maitri Jeans (P) Ltd. is in the business of manufacturing jeans. For the assessment year 2020-21, it paid tax @ 15% on its book profit computed under section 115JB. The Assessing Officer though satisfied that it is liable to pay book profit tax U/s. 115JB, wants to charge interest under sections 234B and 234C as no advance tax was paid during the financial year 2019-20. The company seeks your opinion on the proposed levy of interest. Advice.

Answer

The issue under consideration is whether interest under sections 234B and 234C can be levied where a company is assessed on the basis of its book profit under section 115JB.

The Supreme Court, in Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470, observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted.

According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year.

Under section 115JB(1), where the tax payable on total income is less than 15% of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the

rate of **15%**.

Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.

Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Therefore, even though Maitri Jeans (P) Ltd. is assessed on the basis of its book profit under section 115JB for A.Y.2020-21, it is liable to pay advance tax. Since Maitri Jeans (P) Ltd. has not paid any advance tax during the financial year 2019-20, the levy of interest under section 234B and 234C is valid.

Question 3

Sona Ltd., a resident company, earned a profit of ₹ 15 lakhs after debit/ credit of the following items to its Statement of Profit and Loss for the year ended on 31/03/2020.

(i) Items debited to Statement of Profit and Loss:

No.	Particulars	₹
1.	Provision for the loss of subsidiary	70,000
2.	Provision for doubtful debts	75,000
3.	Provision for income-tax	1,05,000
4.	Provision for gratuity based on actuarial valuation	2,00,000
5.	Depreciation	3,60,000
6.	Interest to financial institution (unpaid before filing of return)	1,00,000
7.	Penalty for infraction of law	50,000

(ii) Items credited to Statement of Profit and Loss:

No.	Particulars	₹
1.	Profit from unit established in special economic zone	5,00,000
2.	Share in income of an AOP as a member	1,00,000
3.	Income from units of UTI	75,000
4.	Long term capital gains on sale of building	3,00,000

Other Information:

(i) Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation as per Income-tax Rules is ₹ 2,80,000.

(iii) Brought forward loss of ₹ 10 lakhs which includes unabsorbed depreciation of ₹ 4 lakhs.

(iv) The AOPs, of which the company is a member, has paid tax at maximum marginal rate.

(v) Provision for income-tax includes ₹ 45,000 of interest payable on income-tax.

Compute minimum alternate tax under section 115JB of the Income-tax Act, 1961, for A.Y. 2020-21, assuming that Sona Ltd. is not required to comply with the Indian Accounting Standards. Ignore the provisions of section 115BAA.

Answer

Computation of "Book Profit" for levy of MAT under section 115JB for A.Y.2020-21

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss		15,00,000
Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB:		
- Provision for the loss of subsidiary	70,000	
- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset	75,000	
- Provision for income-tax	1,05,000	
[As per Explanation 2 to section 115JB, income-tax shall include, inter alia, any interest charged under the Act. Therefore, whole of the amount of provision for income-tax including ₹ 45,000 towards interest payable has to be added]		
- Depreciation	3,60,000	6,10,000
		21,10,000
Less: Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB:		
- Share in income of an AOP as a member	1,00,000	
[In a case, where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable by the company, being a member of AOP, in accordance with the provisions of section 86. Therefore, share in income of an AOP on which no income-tax is payable in accordance with the provisions of section 86, would be reduced while computing book profit, since the same has been credited to statement of profit and loss]		
- Income from units in UTI	75,000	
[Income from units in UTI shall be reduced while computing the book profits, since the same is exempt under section 10(35)]		
- Depreciation other than depreciation on revaluation of assets (₹ 3,60,000 – ₹ 1,50,000)	2,10,000	
- Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account.		
[Lower of unabsorbed depreciation ₹ 4,00,000 and brought forward business loss ₹ 6,00,000 as per books of accounts has to be reduced while computing the book profit]	4,00,000	7,85,000
Book Profit		**13,25,000**

Computation of MAT liability under section 115JB

Particulars	₹
15% of book profit	1,98,750
Add: Health and education cess @ 4%	7,950
Minimum Alternate Tax liability	2,06,700

Notes:

(1) It is only the specific items mentioned under Explanation 1 to section 115JB, which can be adjusted from the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified thereunder, the same cannot be adjusted for computing book profit:

- Interest to financial institution (unpaid before filing of return) and
- Penalty for infraction of law

(2) Provision for gratuity based on actuarial valuation is an ascertained liability [CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]. Hence, the same should not be added back to compute book profit.

(3) As per proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

Question 4

X Ltd., a domestic company, has distributed on 1/11/2019, dividend of ₹ 230 lakh to its shareholders. On 1/10/2019, X Ltd. has received dividend of ₹ 60 lakh from its domestic subsidiary company Y Ltd., on which Y Ltd. has paid dividend distribution tax under section 115-O. Compute the additional income-tax payable by X Ltd. under section 115-O.

Answer

Particulars	₹ in lakh
Dividend distributed by X Ltd.	230
Less: Dividend received from subsidiary Y Ltd.	60
Net distributed profits	**170**
Add: Increase for the purpose of grossing up of dividend(15/85*170)	30
Gross dividend	**200**
Additional income-tax payable by X Ltd. u/s 115-O [15% of ₹ 200 lakh]	30.00
Add: Surcharge @ 12%	3.60
	33.60
Add: Health and education cess @ 4%	1.34
	34.94

Question 5

Yaman Limited is a company in which 60% of the shares are held by Piloo Limited. Yaman Limited declared a dividend amounting to ₹ 35 lacs to its shareholders for the financial year 2018-19 in its Annual General Meeting held on 10th July, 2019. Dividend distribution tax was paid by Yaman Limited on 21st July, 2019. Piloo Limited declared an interim dividend amounting to ₹ 50 lacs on 15th October, 2019.

Compute the amount of tax on dividend payable by Piloo Limited.

What would be your answer, if 58% shares of Piloo Limited are held by Kafi Limited, an Indian company?

Answer

As per section 115-O, dividend distribution tax at the rate of 17.472% (i.e., 15% plus surcharge @ 12% and health and education cess @ 4%) is leviable on dividend declared, distributed or paid by

a domestic company. As per section 115-O(1A), a holding company receiving dividend from its domestic subsidiary company can reduce the same from dividend declared, distributed or paid by it. The dividend from its domestic subsidiary company should be received in the same financial year in which the holding company declares, distributes or pays the dividend. Further, the dividend shall not be considered for reduction more than once.

The conditions to be fulfilled for this purpose are as follows:

(1) The domestic subsidiary company should have paid the dividend distribution tax which is payable on such dividend;

(2) The recipient holding company should be a domestic company;

For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares capital of another company.
Section 115-O (1B) provides that for the purposes of determining the tax on distributed profits payable in accordance with section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115-O(1), be equal to the net distributed profits.

On the basis of the aforesaid provision, dividend distribution tax payable by Piloo Limited shall be computed as follows:

Particulars	₹ in lakh
Dividend distributed by Piloo Ltd.	50.00
Less: Dividend received from subsidiary Yaman Ltd. (60% of ₹ 35 lacs)	21.00
Net distributed profits	29.00
Add: Increase for the purpose of grossing up of dividend ₹ 29 x 100 /85 = ₹ 34.12 minus ₹ 29.00	5.12
Gross dividend	34.12
Additional income-tax payable by Piloo Ltd. u/s 115-O [15% of ₹ 34.12 lakh]	5.12
Add: Surcharge @ 12%	0.61
	5.73
Add: Health and education cess @ 4%	0.23
	5.96

In order to remove the cascading effect of DDT in a multi-tier corporate structure, section 115-O provides that, in case any domestic company (Piloo Ltd., in this case) receives any dividend during the year from any subsidiary company (Yaman Ltd., in this case) and such subsidiary company (Yaman Ltd.) has paid the DDT as payable on such dividend, then, dividend distributed by the holding company (Piloo Ltd.,) in the same year to the extent of dividend received from the subsidiary (Yaman Ltd.), shall not be subject to DDT under section 115-O, irrespective of whether the holding company (Piloo Ltd.) is a subsidiary of any other company (Kafi Ltd., in this case).

Therefore, in spite of the fact that Piloo Ltd. is a subsidiary of Kafi Ltd., it can reduce the amount of dividend received from Yaman Ltd. for computation of dividend distribution tax. Therefore, dividend distribution tax payable by Piloo Ltd. shall be 17.472% of ₹ 34.12 lacs (grossed up amount) i.e. ₹ 5.96 lacs.

Question 6

XYZ Ltd., a domestic company, purchases its own unlisted shares on 4th July, 2019. The consideration for buyback amounted to ₹ 21 lakh, which was paid on the same day. The amount received by the company two years back for issue of such shares determined in the manner specified in Rule 40BB was ₹ 13 lakh. Compute the additional income-tax payable by XYZ Ltd. Compute the interest, if any, payable if such tax is paid to the credit of the Central Government on 29th September, 2019.

What would be your answer if the shares purchased were listed shares, other facts remaining the same?

Answer

XYZ Ltd is liable to pay ₹ 1,86,368 as additional income-tax, which is the amount calculated @ 23.296% (20% plus surcharge @ 12**%** plus health and education cess @ 4%) on ₹ 8 lakh, being its distributed income (i.e., ₹ 21 lakh – ₹13 lakh).

The additional income-tax was payable on or before 18th July, 2019. However, the same was paid only on 29th September 2019.

Period for which interest @ 1% per month or part of a month is leviable -

Period	No. of months/part of month
19th July – 18th August, 2019 (whole of first month)	1
19th August – 18th September, 2019 (whole of second month)	1
19th September – 29th September, 2019 (part of third month)	1
Total number of months	**3**

Interest under section 115QB is payable @ 1% per month for 3 months on the amount of additional tax payable i.e., ₹ 1,86,300 (rounded off as per Rule 119A). Therefore, interest payable under section 115QB is ₹ 5,589.

If the shares purchased were listed shares, additional income-tax would not be attracted in the hands of XYZ Ltd., since the purchase was made before 5.7.2019.

Question 7

A business trust, registered under SEBI (Real Estate Investment Trusts) Regulations, 2014, gives particulars of its income for the P.Y.2019-20:

(1) Interest income from Beta Ltd. – ₹ 4 crore;

(2) Dividend income from Beta Ltd. – ₹ 2 crore;

(3) Short-term capital gains on sale of listed shares of Beta Ltd. – ₹ 1.5 crore;

(4) Short-term capital gains on sale of developmental properties – ₹ 1 crore

(5) Interest received from investments in unlisted debentures of real estate companies – ₹ 10 lakh;

(6) Rental income from directly owned real estate assets – ₹ 2.50 crore

Beta Ltd. is an Indian company in which the business trust holds 100% of the shareholding.

Discuss the tax consequences of the above income earned by the business trust in the hands of the business trust and the unit holders, assuming that the business trust has distributed ₹ 10 crore to the unit holders in the P.Y. 2019-20.

Answer

Tax consequences in the hands of the business trust and its unit holders

(1) Interest income of ₹ 4 crore from Beta Ltd.: There would be no tax liability in the hands of business trust due to pass-through status enjoyed by it under sub-clause (a) of section 10(23FC) in respect of interest income from Beta Ltd., being the special purpose vehicle. Therefore, Beta Ltd. is not required to deduct tax at source on interest payment to the business trust.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of interest income received or receivable from a SPV is deemed income of the unit holder as per section 115UA(3).

The business trust has to deduct tax at source under section 194LBA –

- @ 10%, on interest component of income distributed to resident unit holders; and
- @ 5%, on interest component of income distributed to non-corporate non-resident and foreign companies unit holders.

Interest component of income distributed to unit holders is taxable in the hands of the unit holders – @ 5%, in case of unit holders, being non-corporate non-residents or foreign companies; and at normal rates of tax, in case of resident unit holders.

The interest component of income received from the business trust in the hands of each unit-holder would be determined in the proportion of 4/11.1, by virtue of section 115UA(1).

(2) Dividend income of ₹ 2 crore from Beta Ltd.: The dividend distributed by the SPV to the business trust is exempt by virtue of section 115-O(7), since the SPV is a specified domestic company in which the business trust has become the holder of whole of the nominal value of equity share capital of the company. Further, there would be no tax liability in the hands of the business trust, due to specific exemption provided under sub-clause (b) of section 10(23FC).

Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by virtue of section 10(23FD), there would be no tax liability on the dividend component [referred to in sub-clause (b) of section 10(23FC)] of income distributed to unit holders in their hands.

(3) Short-term capital gains of ₹ 1.50 crore on sale of listed shares of Beta Ltd.: As per section 115UA(2), the business trust is liable to pay tax @ 15% under section 111A in respect of short-term capital gains on sale of listed shares of special purpose vehicle. There would, however, be no tax liability on the capital gain component of income distributed to unit holders, by virtue of the exemption contained in section 10(23FD).

(4) Short-term capital gains of ₹ 1 crore on sale of developmental properties: It is taxable at maximum marginal rate of 42.744% in the hands of the business trust as per section 115UA(2). There would be no tax liability in the hands of the unit holders on the capital gain component of income distributed to them, by virtue of the exemption contained in section 10(23FD).

(5) Interest of ₹ 10 lakh received in respect of investment in unlisted debentures of real estate companies: Such interest is taxable @ 42.744%, being the maximum marginal rate,

in the hands of the business trust, as per section 115UA(2). However, there would be no tax liability in the hands of the unit holders on the interest component of income distributed to them, by virtue of section 10(23FD).

(6) Rental income of ₹ 2.50 crore from directly owned real estate assets: Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the trust as per section 10(23FCA).

Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset held directly by such REIT, no tax is deductible at source under section 194-I.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit holder as per section 115UA(3). The business trust has to deduct tax at source @ 10% under section 194LBA in case of distribution to a resident unit holder and at rates in force in case of distribution to a non-resident unit holder.

The rental income component received from the business trust in the hands of each unit-holder would be determined in the proportion of 2.5/11.1, by virtue of section 115UA(1).

Question 8

The following are the particulars of income of three investment funds for P.Y.2019-20:

Particulars	A	B	C
	₹ in lakh		
Business Income		2	(2)
Capital Gains	16	14	(6)
Income from other sources	4	4	8

Compute the total income of the investment funds and unit-holders for A.Y.2020-21, assuming that:

(1) each investment fund has 20 unit holders each having one unit held by them for a period exceeding 12 months; and

(2) income from investment in the investment fund is the only income of the unit-holder.

If Investment Fund C has the following income components for A.Y. 2021-22, what would be the total income of the fund and the unit holder for that year?
Business Income ₹ 2 lakh

Capital Gains ₹ 9 lakh

Income from Other Sources ₹ 8 lakh

Answer

Computation of total income of the investment fund for A.Y. 2020-21

Particulars	A	B	C
	₹		
Business Income	Nil	2,00,000	Nil
Total Income	**Nil**	**2,00,000**	**Nil**

Computation of total income of a unit holder of the following Investment funds for AY 2020-21

Particulars	A	B	C
	₹		
Capital Gains	80,000	70,000	-
Income from other sources	20,000	20,000	30,000
Total Income	**1,00,000**	**90,000**	**30,000**

Notes:

(i) The total income of Investment Fund B would be chargeable to tax @30% if the fund is a firm and @ 30%/25%, as the case may, if the fund is a company and at the maximum marginal rate, in any other case.

(ii) In case of Investment Fund C, the business loss of ₹ 2 lakh is set-off against income from other sources of ₹ 8 lakh. Loss of ₹ 6 lakh under the head "Capital gains" cannot be set-off against income under any other head. The same can be carried forward by the Unit-holder for set-off in the subsequent years since, the units are held for a period of 12 months or more.

(iii) For A.Y.2021-22, the brought forward capital loss of ₹ 30,000 [₹ 6 lakh/20] can be set- off against capital gains of ₹ 45,000 [₹ 9 lakh/20] by the unit-holder since, the period of holding of units is 12 months or more. Business income of ₹ 2 lakh would be taxable in the hands of the Investment Fund. Income from other sources of ₹ 40,000 (₹ 8 lakh/20) would be taxable in the hands of the unit-holders.

Question 9

Mr. Rajesh has income of ₹ 45 lakhs under the head "Profits and gains of business or profession". One of his businesses is eligible for deduction @ 100% of profits under section 80-IB for A.Y. 2020-21. The profit from such business included in the business income is ₹ 20 lakhs. Compute the tax payable by Mr. Rajesh, assuming that he has no other income during the P.Y. 2019-20.

Answer

Computation of regular income-tax payable under the provisions of the Act

Particulars	₹
Profits and gains of business or profession	45,00,000
Less: Deduction under section 80-IB	20,00,000
Total Income	**25,00,000**
Tax payable	
Up to ₹ 2,50,000	Nil
5% on next ₹ 2,50,000	12,500
20% on next ₹ 5,00,000	1,00,000
30% on balance ₹ 15,00,000	4,50,000
	5,62,500

Computation of Alternate Minimum Tax (AMT)

Particulars	₹
Total Income as per the Income-tax Act, 1961	25,00,000
Add: Deduction under section 80-IB	20,00,000
Adjusted Total Income	**45,00,000**
AMT = 18.5% × 45,00,000 =	8,32,500

Since the regular income-tax payable as per the provisions of the Act is less than the AMT, the adjusted total income of ₹ 45 lakhs would be deemed to be the total income of Mr. Rajesh and he would be liable to pay tax @ 18.5% thereof. The tax payable by Mr. Rajesh for the A.Y.2020-21 would, therefore, be ₹ 8,32,500 plus health and education cess @ 4%, totaling ₹ 8,65,800.

Mr. Rajesh would be eligible for credit to the extent of ₹ 2,80,800 [₹ 8,65,800 – ₹ 5,85,000 (i.e., ₹ 5,62,500 + 4% cess)] to be set-off in the year in which tax on total income computed under the regular provisions of the Act exceeds the AMT. Such credit can be carried forward for succeeding 15 assessment years.

Question 10

Mr. Ram (aged 56) is Karta of his HUF. The HUF consists of himself, his wife and two sons viz. Mr. C (aged 28) and Minor D (aged 16). The HUF is assessed to income tax and has business income from the year 2010-11 onwards. The business income of HUF for the year ended 31.3.2020 is ₹ 5,00,000 (computed). Mr. Ram is employed in a private company and his salary income for the same period is ₹ 6,10,000 (computed).

You are requested to answer the following treating each of them as <u>independent</u> situations:

(i) Mr. C gave cash gift of ₹ 1,00,000 to the HUF of Mr. Ram. What would be the total income of HUF?

(ii) The HUF has one house property fetching rent of ₹ 10,000 per month and some movable assets. There is a proposal to make a partial partition of HUF by allotting the house property to Mr. C. Is it advisable to do a partial partition?

(iii) Minor D earned ₹ 70,000 by use of his special skill and talent. How would his income be taxed?

(iv) A car owned personally by Mr. Ram was blended with HUF during the year. It was leased out for a monthly rent of ₹ 10,000 from 1-10-2019. How would this income be taxed?

Answer

(i) Cash gift of ₹ 1 lakh by Mr. C, Ram's major son, to the HUF of Mr. Ram would not be taxable in the hands of the HUF, since gifts from a relative of the HUF does not fall within the scope of income taxable under section 56(2)(x). Since Mr. C, being Mr. Ram's son, is a member of Ram's HUF, he is a relative of the HUF. Hence the total income of HUF would be ₹ 5 lakhs, being the business income computed.

Note - Salary income of Mr. Ram, the Karta of the HUF, who is employed in a private company would be taxed in his individual hands, since the remuneration earned by the Karta on account of the personal qualifications and exertions and not on account of the investment of the family funds cannot be treated as income of the HUF.

(ii) Partial partition (after 31.12.1978) is not recognized and the HUF, which has been hitherto assessed to tax, shall continue to be liable to be assessed as if no such partial partition has taken place [Section 171(9)].

(iii) The rental income in this case would continue to be assessed in the hands of the HUF, even after partial partition. Therefore, it is not advisable to do a partial partition.

(iv) Income of ₹ 70,000 earned by Minor D by use of his special skill and talent would be taxable in his individual hands. It will not be included in the hands of his parent by virtue of the exception to section 64(1A) contained in the proviso to section 64(1A).

(v) As per section 64(2), where a member of the HUF blends his self-acquired property for inadequate consideration with the HUF, income derived therefrom is deemed to arise to the transferor-member and not to the HUF. In this case, Mr. Ram has blended his personal property (i.e., car) with the HUF.

(vi) Since there is no consideration in case of blending, the income from car computed in the prescribed manner, [which can be as per the presumptive provisions or lease rental of ₹ 60,000 (₹ 10,000 × 6 months) less depreciation] would be deemed as the income of Mr. Ram.

Question 11

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2010. H, I and G were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to ₹ 1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2019 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2010, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2019.

The firm was dissolved on 31.3.2020 and the capital assets of the firm were distributed among the partners on 20.4.2020. The net profit of the firm for the year ended 31.3.2020 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was ₹ 1,50,000:

(i) Interest amounting to ₹ 1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2019 to 31.3.2020.

(ii) Interest amounting to ₹ 50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2019 to 31.3.2020.

(iii) Interest amounting to ₹ 20,000 paid to the Hindu undivided family of partner H @ 18% per annum.

(iv) Payment of ₹ 25,000 towards purchase of television sets (stock in trade) made by crossed cheque on 1.11.2019.

(v) ₹ 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.

(vi) Depreciation amounting to ₹ 15,000 on motor car bought and used exclusively for business purposes, but registered in the name of partner 'H'.

(vii) Depreciation under section 32(1)(ii) amounting to ₹ 37,500 of new machinery bought and installed for manufacture of pens on 1.11.2019 at a cost of ₹ 5,00,000.

(viii) Interest amounting to ₹ 25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

(a) Closing stock-in-trade was valued at ₹ 60,000 as per the method of lower of cost or net realizable value consistently followed by it. The net realizable value of the closing stock-in-trade was ₹ 65,000.

(b) Brought forward business loss relating to the assessment year 2019-20 was

(c) ₹ 50,000.

(d) The fair market value of the capital assets as on 31.3.2020 was ₹ 20,00,000 and the cost of their acquisition was ₹ 15,00,000.

Compute the total income of M/s. HIG for the assessment year 2020-21.

You are required to furnish explanations for the treatment of the various items given above.

Answer

Computation of total income of M/s. HIG for the A.Y. 2020-21

Particulars	₹	₹
Net profit as per profit & loss account		1,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2019 to 30.9.2019 disallowed (total interest ₹ 1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added) **[Note (i)]**	50,000	
Interest to partners on current accounts from 1.4.2019 to 31.3.2020 – not authorized by the deed, hence disallowed **[Note (ii)]**.	50,000	
100% of ₹ 25,000 paid towards purchase of television sets otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account **or through such other electronic mode as may be prescribed** (being stock in trade, hence disallowed) **[Note (iv)]**.	25,000	
Difference on account of valuation of closing stock- in-trade at market value (₹ 65,000 less ₹ 60,000) [Note (ix)]	5,000	
Salary paid to working partners considered separately.	2,50,000	3,80,000
		5,30,000
Less: Additional depreciation on new machinery (₹ 5,00,000 x 20%) = ₹ 1,00,000. Only 50% is allowable as deduction. **[Note (vii)]**		50,000
		4,80,000
Less: Interest received from bank on fixed deposits considered separately		25,000
		4,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		
On first ₹ 3,00,000 @ 90%	2,70,000	
On the balance of ₹ 1,55,000 @ 60%	93,000	

	3,63,000	
(ii) Salary actually paid	2,50,000	
Deduction allowed being (i) or (ii) whichever is less		2,50,000
		2,05,000
Less: Business loss relating to assessment year 2019-20 set off		50,000
Income from business		**1,55,000**
Income from other sources		
Interest received from bank on fixed deposits **[Note (viii)]**.		25,000
Total Income		**1,80,000**

Notes:

(i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2019 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2019. Interest for the period prior to 1.10.2019 is not allowed.

(ii) The partnership deed of 1.10.2019 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in Novel Distributing Enterprises v. DCIT (2001) 251 ITR 704 (Ker), on identical facts, held that interest paid to the partners on their current account balances is not allowable.

(iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv).

(iv) Section 40A(3) provides for disallowances @ 100% of the expenditure incurred otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed. Since the firm has made payment of ₹ 25,000 towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.

(v) Gold jewellery valued at ₹ 30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business. Since it has already been credited to profit and loss account, no further adjustment is required.

(vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775.

(vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(iia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%. The balance additional depreciation can be claimed in the immediately succeeding financial year.

(viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.

(ix) As per para 24 of ICDS II: Valuation of Inventories, closing stock has to be valued at net realizable value in the case of a dissolved firm. As such, the closing stock- in-trade of the firm has to be valued at the net realizable value of ₹ 65,000. Since it has been valued at ₹ 60,000, being the cost, the balance ₹ 5,000 has to be added.

(x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per Explanation 3 to section 40(b). Carry forward and set off of business loss is covered under Chapter

(xi) VI. Hence, brought forward business loss relating to the assessment year 2019- 20 is not considered for calculation of book-profit.

(xii) Section 45(4) is not applicable to the firm for the assessment year 2020-21, though the dissolution of the firm took place on 31.3.2020, as there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2020. The capital gains will, therefore, be assessable in the assessment year 2021-22.

Question 12

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-04-2019 after a search. The tax liability of the firm outstanding to be paid was determined at ₹ 15 lakhs. Out of three partners, one was declared insolvent on 18-03-2020 by the Court. The Assessing Officer, for recovering the demand, attached the Bank Accounts of other two partners and could recover an amount of ₹ 6 lakhs from the Account of one such partner. You are asked by the partners of the dissolved firm the following questions:

(i) About the liability of each of them to pay outstanding demand.

(ii) Whether the action of Assessing Officer to attach the Bank Account of partners to recover the tax demand of the dissolved firm is justified?

Answer

(i) As per section 189(3), every person who was at the time of dissolution, a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act relating to assessment of such tax or imposition of such penalty or other sum, shall apply. Therefore, the three partners (till one was declared as insolvent by the Court) are jointly and severally liable for making the payment of outstanding dues of ₹ 15 Lakhs. After insolvency of one partner, the other two partners are jointly and severally liable to pay such demand.

(ii) Accordingly, the action of the Assessing Officer to attach the bank accounts of the partners for recovery of outstanding demand is correct and the amount of ₹ 6 lakhs recovered by attachment of the bank account of one of the partners is also in order.

Question 13

JK Associates is an Association of Persons (AOPs) consisting of two members, J and K. Shares of the members are: 60%(J) and 40%(K). Income of the AOPs for the previous year 2019-20 is ₹ 7 lacs.

Compute tax liability of the AOP and the members in the following situations:

(i) J and K have their income, other than income from AOPs, amounting to ₹ 1 lac and ₹ 2.7 lacs, respectively.

(ii) J and K's income, other than income from AOPs, amount to ₹ 1.50 lac and ₹ 2.30 lacs,

respectively.

Answer

Computation of tax of AOPs is governed by section 167B of the Income-tax Act, 1961. Tax on total income of AOP is computed as follows:

(i) If individual share of a member is known, and the total income of any member, excluding his share from such AOPs, exceeds the basic exemption limit, then the AOPs will pay tax at the maximum marginal rate.

(ii) If individual share of a member is known and no member has total income (excluding his share from AOPs) exceeding the basic exemption limit, then the AOP will pay tax at the rates applicable to an individual.

Section 86 provides for assessment of share in the hands of members of AOPs as follows:

A member's share in the total income of AOPs will be treated as follows:-

(i) If an AOPs has paid tax at the maximum marginal rate or a higher rate, the member's share in the total income of AOPs will not be included in his total income and will be exempt.

(ii) If the AOPs has paid tax at regular rates applicable to an individual, the member's share in the income of AOPs will be included in his total income and he will be allowed rebate at the average rate of tax in respect of such share.

Tax Liability of J K Associates, AOPs

(i) As K's income, other than that from the AOPs, exceeds the basic exemption limit, the AOPs shall pay tax at **maximum marginal rate of 42.744 % (i.e. 30% plus 37% surcharge plus health and education cess @ 4%).** Thus, the tax payable by AOP = ₹ 7,00,000 x 42.744% = ₹ 2,99,208.

(ii) Since none of the members have income, other than income from the AOPs, exceeding the basic exemption limit, the AOPs would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability = ₹ 52,500 + ₹ 2,100 = ₹54,600.

Tax Liability of J and K

	Particulars	**J** ₹	**K** ₹
(i)	Share of profit from AOP	Exempt	Exempt
	Income from other sources	1,00,000	2,70,000
	Total Income	1,00,000	2,70,000
	Tax liability	NIL	1,000
	Less: Rebate under section 87A	-	1,000
	Total tax payable	NIL	NIL
(ii)	Share of profit from AOP	4,20,000	2,80,000
	Income from other sources	1,50,000	2,30,000
	(A)	5,70,000	5,10,000
	Tax liability	26,500	14,500
	Add: Health and Education cess @ 4%	1,060	580
	Total tax payable (B)	27,560	15,080
	Average rate of tax [B/A x 100]	4.835%	2.957%

Total tax liability	27,560	15,080
Less: Rebate under section 86 read with section 110 in respect of share of profit from AOP (share in AOP x Average rate of tax)	20,307	8,280
Tax liability of members	7,253	6,800
Tax Payable (Rounded off)	7,250	6,800

Question 14

Transfer fees are received by a cooperative housing society from its incoming and outgoing members. Are such transfer fees liable to tax in the hands of the cooperative society?

Answer

The issue under consideration is whether the transfer fees received by a co-operative housing society from its incoming and outgoing members is taxable or exempt on the principle of mutuality.

On this issue, the High Court, in Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47, observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on account of the principle of mutuality, since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Applying the rationale of the above ruling, transfer fees received by a co-operative housing society from its incoming and outgoing members would not be liable to tax in the hands of the co-operative society.

Question 15

XYZ Ltd. is engaged in the manufacture of textile since 01-04-2009. Its Statement of Profit & Loss shows a profit of ₹ 700 lakhs after debit/credit of the following items:

(1) Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 is ₹ 50 lakhs.

(2) Employer's contribution to EPF of ₹ 2 lakhs and Employees' contribution of ₹ 2 lakhs for the month of March, 2020 were remitted on 8th May 2020.

(3) The company appended a note to its Income Statement that industrial power tariff concession of ₹ 2.5 lakhs was received from the State Government and credited the same to Statement of P & L.

(4) The company had provided an amount of ₹ 25 lakhs being sum estimated as payable to workers based on agreement to be entered with the workers union towards periodical wage

revision once in 3 years. The provision is based on a fair estimation on wage and reasonable certainty of revision once in 3 years.

(5) The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31-03-2020 was ₹ 200 lakhs.

(6) A debtor who owed the company an amount of ₹ 40 lakhs was declared insolvent and hence, was written off by debit to Statement of Profit and loss.

(7) Sundry creditors include an amount of ₹ 50 lakhs payable to A & Co, towards supply of raw materials, which remained unpaid due to quality issues. An agreement has been made on 31-03-2020, to settle the amount at a discount of 75% of the outstanding. The amount waived is credited to Statement of Profit and Loss.

(8) The opening and closing stock for the year were ₹ 200 lakhs and ₹ 255 lakhs, respectively. They were overvalued by 10%.

(9) Provision for gratuity based on actuarial valuation was ₹ 500 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 300 lakhs.

(10) Commission of ₹ 1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIB of the Act.

(11) The company has purchased 500 tons of industrial paper as packing material at a price of ₹ 30,000/ton from PQR, a firm in which majority of the directors are partners. PQR's normal selling price in the market for the same material is ₹ 28,000/ton.

Additional Information:

(1) There was an addition to Plant & Machinery amounting to ₹ 50 lakhs on 10-06-2019, which was used for more than 180 days during the year. Additional depreciation has not been adjusted in the books.

(2) Normal depreciation calculated as per Income-tax Rules, 1962 is ₹ 80 lakhs.

(3) The company had credited a sub-contractor an amount of ₹ 10 lakhs on 31-03-2019 towards repairing a machinery component. The tax so deducted was remitted on 31-12-2019.

(4) The company has collected ₹ 7 lakhs as GST from its customers and paid the same on the due dates. However, on an appeal made, the High Court directed the Department to refund ₹ 3 lakhs to the company. The company in turn refunded ₹ 2 lakhs to the customers from whom the amount was collected and the balance of ₹ 1 lakh is still lying under the head "Current Liabilities".

Compute total income and tax payable for A.Y. 2020-21. Ignore MAT provisions and the provisions of section 115BAA.

Note - The turnover of XYZ Ltd. for the P.Y.2017-18 was ₹ 405 crore.

Answer

Computation of Total Income of XYZ Ltd. for the A.Y.2020-21

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
Profit as per Statement of profit and loss		7,00,00,000
Add: Items debited but to be considered separately or to be disallowed		
(a) Depreciation as per Companies Act, 2013	50,00,000	

(b)	Employees' contribution to EPF **[See Note 1 below]** [Since employees' contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per section 36(1)(va). Since the same has been debited to Statement of profit and loss, it has to be added back for computing business income].	2,00,000	
(c)	Employer's contribution to EPF [As per section 43B, employers' contribution to EPF is allowable as deduction since the same has been deposited on or before the 'due date' of filing of return under section 139(1). Since the same has been debited to Statement of profit and loss, no further adjustment is necessary]	Nil	
(d)	Provision for wages payable to workers [The provision is based on fair estimate of wages and reasonable certainty of revision, the provision is allowable as deduction, since ICDS X requires 'reasonable certainty for recognition of a provision, which is present in this case. As the provision has been debited to Statement of profit and loss, no adjustment is required while computing business income]	Nil	
(e)	Provision for doubtful debts [10% of ₹ 200 lakhs] [Provision for doubtful debts is allowable as deduction under section 36(1)(viia) only in case of banks, public financial institutions, state financial corporations, state industrial investment corporations and non-banking financial corporations. Such provision is not allowable as deduction in the case of a manufacturing company. Since the same has been debited to Statement of profit and loss, it has to be added back for computing business income]	20,00,000	
(f)	Bad debts written off [Bad debts write off in the book of account is allowable as deduction under section 36(1)(vii). Since the same has already been debited to Statement of profit and loss, no further adjustment is required]	Nil	
(g)	Provision for gratuity [Provision of ₹ 500 lakhs for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of ₹ 300 lakhs paid is allowable as deduction. Hence, the difference has to be added back]	2,00,00,000	
(h)	Commission paid to recovery agent for realization of a debt. [Commission of ₹ 1 lakh paid to a recovery agent for realisation of a debt is an allowable expense under section 37 as per DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All). Since the same has been debited to Statement of profit and loss, no further adjustment is required]	Nil	
(i)	Purchase of paper at a price higher than the fair market value	10,00,000	

	[As per section 40A(2), the difference between the purchase price (₹ 30,000 per ton) and the fair market value (₹ 28,000 per ton) multiplied by the quantity purchased (500 tons) has to be added back since the purchase is from a related party, a firm in which majority of the directors are partners, at a price higher than the fair market value]		
(j)	Sales tax not refunded to customers out of sales tax refund	1,00,000	
	[The amount of sales tax refunded to the company by the Government is a revenue receipt chargeable to tax under section 41(1). Deduction can be claimed of amount refunded to customers [CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)]. Hence, the net amount of ₹ 1,00,000 (i.e., ₹ 3,00,000 minus ₹ 2,00,000) would be chargeable to tax]		2,83,00,000
			9,83,00,000
***Less*: Items credited but to be considered separately/ permissible expenditure and allowances**			
(k)	Industrial power tariff concession received from State Government	Nil	
	[Any assistance in the form of, inter alia, concession received from the Central or State Government would be treated as income as per section 2(24)(xviii). Since the same has been credited to Statement of profit and loss, no adjustment is required.		
(l)	Discount given by Sundry Creditors for supply of raw materials	Nil	
	[Discount of 75% given by Sundry Creditors for supply of raw materials is taxable under section 41(1). Since the same has already been credited to Statement of profit and loss, no further adjustment is required]		
(m)	Depreciation as per Income-tax Act, 1961	80,00,000	
(n)	Over-valuation of stock [₹ 55 lakhs × 10/110]	5,00,000	
	[The amount by which stock is over-valued has to be reduced for computing business income. ₹ 50 lakhs, being the difference between closing and opening stock, has to be adjusted to remove the effect of over-valuation]		
(o)	Additional Depreciation **[See Note 2 below]**	10,00,000	
	[Additional depreciation @ 20% is allowable on ₹ 50 lakhs, being actual cost of new plant & machinery acquired on 10.06.2019, as the same was put to use for more than 180 days in the P.Y.2019-20.]		
(p)	Payment to a sub-contractor where tax deducted last year was remitted after the due date of filing of return **[See Note 3 below]**	3,00,000	
	[30% of ₹ 10 lakhs, being payment to a sub-contractor,		

would have been disallowed under section 40(a)(ia) while computing the business income of A.Y.2019-20, since tax deducted was remitted after the due date of filing of return. However, the same is allowable in A.Y.2020-21, since the remittance has been made on 31.12.2019]		98,00,000
Total Income		**8,85,00,000**

Computation of tax liability of XYZ Ltd. for A.Y.2020-21

Particulars	₹
Tax @ 30% on the above total income (since the turnover exceeded ₹ 400 crore in the P.Y. 2017-18)	2,65,50,000
Add: Surcharge @ 7% (since total income exceeds ₹ 1 crore but less than ₹ 10 crore)	18,58,500
	2,84,08,500
Add: Health and Education cess @ 4%	11,36,340
Total tax liability	**2,95,44,840**

Notes:

(1) Employees contribution to PF deposited after the due date mentioned under the PF Act is not allowable as deduction as per section 36(1)(va). The same has also been affirmed by the Gujarat High Court in CIT v. Gujarat State Road Transport Corporation (2014) 366 ITR 170. Hence, in the above solution, employees' contribution to PF has been disallowed while computing business income.

The CBDT has, vide Circular No. 22/2015, dated 17.12.2015, clarified that the employer contribution to provident fund remitted on or before due date of filing of return under section 139(1), is allowable as deduction while computing Business Income. Further, it has also clarified that the circular does not apply to claim of deduction relating to employee's contribution welfare funds which are governed by section 36(1)(va) of the Act.

Alternate View - An alternate view has, however, been expressed in CIT v. Kiccha Sugar Co. Ltd. (2013) 356 ITR 351 (Uttarakhand), CIT v. AIMIL Ltd (2010) 321 ITR 508 (Del) and CIT v. Nipso Polyfabriks Ltd (2013) 350 ITR 327 (HP) that employees contribution to PF, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the provident fund authority on or before the due date of filing of return for the relevant previous year. If this view is considered, then no disallowance would be attracted in this case, since the employees' contribution has been remitted before the due date of filing of return of income.

(2) ₹ 50 lakhs, being the addition to plant and machinery on 10.6.2019 qualifies for additional depreciation @ 20% under section 32(1)(iia). Since only the normal depreciation as per Income-tax Rules, 1962, has been debited to profit and loss account, additional depreciation of ₹ 10 lakhs (being 20% of ₹ 50 lakhs) has to be deducted while computing business income.

(3) Since the tax deducted during the P.Y.2018-19 was remitted only on 31.12.2019, i.e., after the due date of filing of return for A.Y. 2019-20, ₹ 3,00,000, being 30% of ₹ 10 lakh would have been disallowed while computing the business income of that year. Since the tax

deducted has been remitted on 31.12.2019, ₹ 3,00,000 would be allowed as deduction while computing the business income of the A.Y.2020-21.

Question 16

Parik Hospitality Limited is engaged in the business of running hotels of 3-star category. The company's Statement of Profit and Loss for the previous year ended 31st March, 2020 shows a profit of ₹ 152 lakhs after debiting or crediting the following items:

(a) Payment of ₹ 0.25 lakh and ₹ 0.30 lakh in cash on 3rd December, 2019 and 10th December, 2019, respectively, for purchase of crab, lobster and squid to Mr. Raja, a fisherman, and Mr. Khalid, a middleman for these products, respectively.

(b) Contribution towards employees' pension scheme notified by the Central Government under section 80CCD for a sum of ₹ 3 lakhs calculated at 12% of basic salary and Dearness Allowance payable to the employees.

(c) Payment of ₹ 6.50 lakhs towards transportation of various materials procured by one of its hotels to M/s. Bansal Transport, a partnership firm, without deduction of tax at source. The firm opts for presumptive taxation under section 44AE and has furnished a declaration to this effect. It also furnished its Permanent Account Number in the tender document.

(d) Profit of ₹ 12 lakhs on sale of a plot of land to Avimunya Limited, a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by Parik Hospitality Limited on 1st June, 2018.

(e) Contribution of ₹ 2.50 lakhs to Indian Institute of Technology with a specific direction for use of the amount for scientific research programme approved by the prescribed authority.

(f) Expense of ₹ 10 lakhs on foreign travel of two directors for a collaboration agreement with a foreign company for a brewery project to be set up. The negotiation did not succeed and the project was abandoned.

(g) Fees of ₹ 1 lakh paid to independent directors for attending Board meeting without deduction of tax at source under section 194J.

(h) Depreciation charged ₹ 10 lakhs.

(i) ₹ 10 lakhs, being the additional compensation received from the State Government pursuant to an interim order of Court in respect of land acquired by the State Government in the previous year 2015-16.

(j) Dividend received from a foreign company ₹ 5 lakhs.

Additional information:

(i) As a corporate debt restructuring, the bank has converted unpaid interest of ₹ 10 lakhs upto 31st March, 2019 into a new loan account repayable in five equal annual installments. The first installment of ₹ 2 lakhs was paid in March, 2020 by debiting new loan account.

(ii) Depreciation as per Income-tax Act, 1961 ₹ 15 lakhs.

(iii) The company received a bill for ₹ 2 lakhs on 31st March 2020 from a supplier of vegetables for supply made in March, 2020. The bill was omitted to be recorded in the books in March, 2020. The bill was paid in April, 2020 and the necessary entry was made in the books then.

Compute total income of Parik Hospitality Limited for the Assessment Year 2020-21 indicating the reason for treatment of each item. Ignore the provisions relating to minimum alternate tax and the provisions of section 115BAA.

Answer

Computation of Total Income of Parik Hospitality Ltd. for the A.Y.2020-21

Particulars	Amount (₹)	
Profit as per Statement of profit and loss		1,52,00,000
Add: Items debited but to be considered separately or to be disallowed		
(a) Payment to middleman for purchase of crab etc. in an amount exceeding ₹10,000	30,000	
[Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding ₹ 10,000 is made on a day to a person. Payment of ₹ 25,000 to fishermen for purchase of crab etc. is covered by exception under Rule 6DD. However, payment of ₹30,000 to middlemen for purchase of crab etc. is not covered under the exception - CBDT Circular 10/2008 dated 5/12/2008].		
(b) Contribution towards employees' pension scheme in excess of 10% of salary disallowed under section 40A(9)	50,000	
[Contribution to the extent of 10% of salary (basic salary + dearness allowance, if it forms part of pay for retirement benefits) is allowable as deduction under section 36(1)(iva). In this case, it is presumed that dearness allowance forms part of pay for retirement benefits]		
(c) Payment to transport contractor without deduction of tax at source	-	
[Since the contractor opts for presumptive taxation under section 44AE and furnished a declaration to this effect, tax is not required to be deducted at source under section 194C in respect of payment to transport contractor].		
(f) Expenses on foreign travel of two directors for a collaboration agreement which failed to materialize	10,00,000	
[Where expenditure is incurred for a project not related the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature as per Mc Gaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.). Brewery project is not related to the existing business of running three star hotels]		
(g) Fees paid to directors without deducting tax at source [30% of ₹ 1 lakh]	30,000	11,10,000
[Disallowance @ 30% would be attracted under section 40(a)(ia) for non-deduction of tax at source from director's remuneration on which tax is deductible under section 194J]]		

		1,63,10,000
Less: Items credited but to be considered separately/ Expenditure to be allowed		
(d) Profit on sale of plot of land to 100% subsidiary	12,00,000	
[Short-term capital gains arise on sale of plot of land held for less than 24 months. However, in this case, since the transfer is to a 100% subsidiary company and the subsidiary company is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv). Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income].		
(e) Contribution to IIT for scientific research	1,25,000	
[Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for weighted deduction @ 150% under section 35(2AA). Since 100% of contribution has already been debited to the statement of profit and loss, the balance 50% has to be deducted while computing business income] 7.		
(h) Depreciation	5,00,000	
[Depreciation allowable under the Income-tax Act, 1961 is ₹ 15 lakhs whereas the depreciation as per books of account debited to the statement of profit and loss is ₹ 10 lakhs. Hence, the additional amount of ₹ 5 lakhs has to be deducted while computing business income]		
(i) Additional compensation received from State Government	10,00,000	
[Since the additional compensation has been received pursuant to an interim order of the Court, the same would be deemed as income chargeable to tax under the head "Capital Gains" in the year of final order as per section 45(5). Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income]		
(j) Dividend received from foreign company	5,00,000	
[Dividend received from foreign company is taxable under the head "Income from other sources". Since the said dividend has been credited to the statement of profit and loss, the same has to be deducted while computing business income]		
(i) Interest paid during the year	2,00,000	
[Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 2 lakhs has been paid in the P.Y. 2019-20, the same is allowable as deduction]		

(iii) Purchases omitted to be recorded in the books	2,00,000	
[Since the purchase is made in March, 2020 (i.e., P.Y. 2019-20), in respect of which bill of ₹ 2 lakhs received on 31.3.2020 has been omitted to be recorded in the books in that year, it has to be deducted to compute the business income [Kedarnath Jute Manufacturing Company Ltd. v. CIT (1971) 82 ITR 363 (SC)]. It is logical to assume that the company is following mercantile system of accounting.].		37,25,000
Income under the head "Profits and Gains of Business or Profession"		**1,25,85,000**
Income from Other Sources		
Dividend received from foreign company		
[Dividend received from a foreign company is chargeable to tax under the head "Ïncome from other sources".]		5,00,000
Gross Total Income		**1,30,85,000**
Less: Deduction under Chapter VI-A		Nil
Total Income		**1,30,85,000**

Question 17

Hyper Ltd., engaged in diversified activities, earned a profit of ₹ 14,25,000 after debit/credit of the following items to its statement of profit and loss for the year ended on 31.3.2020:

		₹
(a)	Items debited to Statement of Profit and Loss	
	Provision for loss of subsidiary	70,000
	Provision for income-tax demand	1,05,000
	Expenses on purchase/sale of equity shares	15,000
	Depreciation	3,60,000
	Interest on deposit credited to buyers on 31.3.2020 for advance received from them, on which TDS was deducted in April 2020 and was deposited on 31.7.2020	1,00,000
(b)	Items credited to Statement of Profit and Loss	
	Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale	3,60,000
	Income from units of UTI	75,000

The company provides the following additional information:

(i) Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation allowable as per Income-tax Rules is ₹ 2,80,000.

(iii) Brought forward Business Loss/ Unabsorbed Depreciation:

F.Y.	Amount as per books		Amount as per Income-tax	
	Loss ₹	Depreciation ₹	Loss ₹	Depreciation ₹

2015-2016	2,50,000	3,00,000	2,00,000	2,50,000
2016-2017	Nil	2,70,000	1,00,000	1,80,000
2017-2018	3,50,000	3,15,000	1,20,000	2,10,000

You are required to:

(i) compute the total income of the company for the assessment year 2020-21 giving the reasons for treatment of items and

(ii) examine the applicability of section 115JB of the Income-tax Act, 1961, and compute book profit and the tax credit to be carried forward.

Assume the tax rate applicable to Hyder Ltd for the P.Y. 2019-20 is 30%. Ignore the provisions of section 115BAA.

Answer

Computation of total income of M/s Hyper Ltd. for the A.Y. 2020-21

Particulars	₹	₹
Profit as per Statement of Profit & Loss		14,25,000
Add: Items disallowed/ considered separately		
Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]	70,000	
Provision for income-tax [disallowed under section 40(a)(ii)]	1,05,000	
Expenses on transfer of shares [not deductible from business income. It is to be deducted from gross sale consideration while computing capital gains]	15,000	
Interest on deposit credited on 31.3.2020 and tax deducted in April 2020 which was deposited on 31.7.2020 [30% disallowed under section 40(a)(ia) since, tax is deducted only in the next year].	30,000	
Depreciation debited to statement of profit and loss [only depreciation calculated as per the Income-tax Rules, 1962 is allowable as deduction]	3,60,000	5,80,000
		20,05,000
Less: Items credited but not includible under business income or are exempt under the provisions of the Act		
Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.	3,60,000	
Income from units of UTI, since it is not a business income.	75,000	4,35,000
		15,70,000
Less: Depreciation (allowable as per the Income-tax Rules, 1962)		2,80,000
		12,90,000
Less: Set-off of brought forward business loss and unabsorbed depreciation		
Brought forward business loss under section 72	4,20,000	
Brought forward depreciation under section 32	6,40,000	10,60,000
Income from business		**2,30,000**
Capital Gains		

Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale		3,60,000
Income from Other Sources		
Income from units of UTI	75,000	
Less: Exempt under section 10(35)	75,000	Nil
Total Income		**5,90,000**
Tax on LTCG exceeding ₹ 1 lakh @ 10%		26,000
Tax on other income of ₹ 2,30,000 @ 30%		69,000
		95,000
Add: Health and Education cess @ 4%		3,800
Tax Payable as per the Income-tax Act, 1961		**98,800**

Computation of Book Profit under section 115JB

Particulars	₹	₹
Profit as per Statement of Profit & Loss		14,25,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 below section 115JB(2)		
Provision for loss of subsidiary	70,000	
Provision for income-tax	1,05,000	
Depreciation debited to statement of profit and loss	3,60,000	5,35,000
		19,60,000
Less: Net Profit to be reduced by the following amounts as per Explanation 1 below section 115JB(2)		
Depreciation debited to statement of profit and loss (excluding depreciation on account of revaluation of fixed assets) (i.e., ₹ 3,60,000 – ₹1,50,000)	2,10,000	
Income from UTI [since it is an income exempt u/s 10(35)]	75,000	
Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less, taken on cumulative basis	6,00,000	8,85,000
Book Profit		**10,75,000**
15% of book profit		1,61,250
Add: Health and Education cess @ 4%		6,450
		1,67,700

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years.

The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act. This tax credit is allowed to be carried forward for 15 assessment years succeeding the assessment year in which the credit became allowable.

Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	₹
Tax on book profit under section 115JB	1,67,700
Less: Tax on total income computed as per the other provisions of the Act	98,800
Tax credit to be carried forward under section 115JAA	**68,900**

Question 18

The profit as per the statement of profit and loss of XYZ Ltd., a resident company, for the year ended 31.3.2020 is ₹ 190 lacs arrived at after making the following adjustments:

	Particulars	₹ (in lacs)
(i)	Depreciation on assets	100
(ii)	Reserve for currency exchange fluctuation	50
(iii)	Provision for tax	40
(iv)	Proposed dividend	120

Following further information are also provided by company:

(a) Profit includes ₹ 10 lacs, being dividend received from an Indian subsidiary company.

(b) Provision for tax includes ₹ 16 lacs of tax payable on distribution of profit and of ₹ 2 lacs of interest payable on income-tax.

(c) Depreciation includes ₹ 40 lacs towards revaluation of assets.

(d) Amount of ₹ 50 lacs credited to statement of P & L was drawn from revaluation reserve.

(e) Balance of statement of profit and loss shown in balance sheet at the asset side as at 31.3.2019 was ₹ 30 lacs which includes unabsorbed depreciation of ₹ 10 lakhs.

Compute the book profit for the year ended 31.3.2020.

Answer

Computation of book profit of XYZ Ltd. for the year ended 31.3.2020

Particulars	₹	₹
Profit as per Statement of Profit & Loss		1,90,00,000
Add: Net profit to be increased by the following amounts as per Explanation 1 below section 115JB(2)		
Depreciation on assets debited to Statement of P&L	1,00,00,000	
Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, is to be added back	50,00,000	
Provision for tax **(See Note below)**	40,00,000	
Proposed dividend	1,20,00,000	3,10,00,000
		5,00,00,000
Less: Net profit to be decreased by the following amounts as per Explanation 1 below section 115JB(2)		
Depreciation other than depreciation on revaluation of assets (₹ 100 lacs - ₹40 lacs)	60,00,000	

Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets (₹ 50 lacs or ₹ 40 lacs, whichever is less)	40,00,000	
Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. Unabsorbed depreciation ₹ 10 lakhs and brought forward business loss ₹ 20 lakhs – whichever is less	10,00,000	
Dividend income [since the same is exempt under section 10(34)]	10,00,000	1,20,00,000
Book profit		**3,80,00,000**

Note – For the purpose of section 115JB, book profit means the profit as per the statement of profit and loss prepared in accordance with Schedule III to the Companies Act, 2013, as adjusted by certain additions/deductions as specified. One of the adjustments is to add back income-tax paid or payable, and the provisions therefor. Explanation 2 after sub-section (2) of section 115JB clarifies that income- tax includes, inter alia, dividend distribution tax/ tax on distributed income and interest. Therefore, the entire provision of ₹40 lacs for income-tax is added back for computing book profit for levy.

Question 19

Mr. Harish, aged 66, running business as a proprietor furnishes the particulars of his income for the year ended 31.03.2020 as under:

(a) Net Profit of ₹ 3,65,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the Profit & Loss Account:

  (i) Personal travelling expenses of ₹ 12,750.
  (ii) Purchase of furniture items for shop on 13.6.2019 of ₹ 25,000 but charged in shop expenses.

(b) He owns a house with two floors constructed with the financial assistance of HDFC, out of which ground floor is used by him for self-use and first floor was let out on rent for ₹ 8,500 p.m. from April, 2019. The municipal tax paid for the whole house was of ₹ 2,500 and interest paid on housing loan for the construction was ₹ 52,000. Both the floors of the house are identical.

(c) He deposited insurance premium on the life of self of ₹ 12,500, wife ₹ 13,500, son and daughter of ₹ 28,000, repaid housing loan of ₹ 50,000 and paid ₹ 55,000 by credit card for health insurance of himself and his family.

Compute taxable income and the amount of tax payable by Mr. Harsh on such income for the Assessment Year 2020-21.

Answer

Computation of total income of Mr. Harsh for the A.Y.2020-21

Particulars	₹	₹
Income from house property		
Self-occupied portion (50%)		
Annual Value under section 23(2)	Nil	
Less: Deduction under section 24(b)		
Interest on housing loan [₹ 52,000 × 50%]	26,000	
Let-out portion (50%)		(26,000)
Income of let out portion being rent of ₹ 8,500 p.m. received for		

12 months (Rent received has been taken as the GAV in the absence of other information).		
Gross Annual Value under section 23(1) (₹ 8,500 × 12)	1,02,000	
Less: 50% of municipal taxes paid allowable in respect of rented out portion (i.e., 50% of ₹ 2,500)	1,250	
Net Annual Value (NAV)	1,00,750	
Less: Deduction under section 24		
30% of NAV under section 24(a)	30,225	
Interest on housing loan under section 24(b)	26,000	
		44,525
		18,525
Profits and gains of business or profession		
Net profit as per profit and loss account of wholesale business of textiles and fabrics	3,65,500	
Add: Expenses charged in profit and loss account either not allowable or to be considered separately -		
Personal travelling expenses of proprietor	12,750	
Purchase of furniture wrongly debited to shop expenses	25,000	
	4,03,250	
Less: Depreciation on furniture @ 10% on ₹ 25,000	2,500	4,00,750
Gross Total Income		**4,19,275**
Less: Deduction under Chapter VI-A		
Under section 80C		
- Life insurance premium		
Self	12,500	
Wife	13,500	
Son and daughter	28,000	
- Housing loan repaid	50,000	
	1,04,000	
Under section 80D [Medical insurance premium]		
Mediclaim insurance premium of ₹ 55,000 [maximum deductible is ₹ 50,000 where it covers a resident senior citizen]	50,000	1,54,000
Total Income		**2,65,275**
Total Income (rounded off)		2,65,280
Tax on total income of ₹ 2,65,280		Nil
(The basic exemption limit for senior citizen is ₹ 3,00,000 for A.Y. 2020-21)		

Question 20

X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms. In the previous year 2018-19, one partner 'A' retired, but his dues have been settled in the previous year 2019-20.

The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June, 2019 to authorise payment of remuneration of ₹ 1 lac per month to each working partner and simple interest at 15% per annum on partners' capital. X, Y and Z are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March, 2020 shows a net profit of ₹ 10 lacs after debiting/crediting the following:

(a) Interest amounting to ₹ 5 lacs each was paid to partners on the balances standing to their capital accounts from 1st June, 2019 to 31st March, 2020.

(b) Remuneration to the partners including partner in representative capacity ₹ 30 lacs.

(c) Interest amounting to ₹ 2 lacs paid to Z on loan provided by him in his individual capacity at 16% interest.

(d) Royalty of ₹ 5 lacs paid to partner X, who is a professional script writer, for use of his scripts as per agreement between the firm and X. The same is authorized by partnership deed.

(e) Two separate payments of ₹ 18,000 and ₹ 15,000 made in cash on 1st February, 2020 to Altaf, a hairdresser, against his bill for services rendered in January, 2020 and two payments of ₹ 19,000 and ₹ 10,000 made in cash on 1st February and 2nd February, 2020, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2020.

(f) Amount of ₹ 5 lacs provided in the books on 31st March 2020 as liability for remuneration to Shreya, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June, 2020.

(g) Amount of ₹ 6 lacs provided as gratuity for the year on the basis of actuarial valuation. Gratuity actually paid to one retired employee during the year is ₹ 1.50 lacs.

(h) Interest of ₹ 1.20 lacs received on income-tax refund under section 244(1A) in respect of A.Y. 2017-18.

The firm has also provided the following additional information:

The amount due to A, an ex-partner, was ₹ 15 lacs which was settled on 30th September, 2019 by transferring a plot of land purchased one year back having book value of ₹ 10 lacs. The difference of ₹ 5 lacs was credited to partners' capital accounts in their profit-sharing ratio. The value of plot for stamp duty valuation on the date of transfer was ₹ 16 lacs.

Compute the total income of the firm for the assessment year 2020-21 stating the reasons for treatment of each item.

Answer

Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2020-21

Particulars	₹	₹
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000
Add: Expenses disallowed or considered separately:		
Interest to partners in excess of 12% **(Note 1)**	3,00,000	
Disallowance under section 40A(3) for aggregate cash payment exceeding ₹ 10,000 in a single day **(Note 5)**	52,000	
Provision for gratuity **(Note 7)**	4,50,000	
Partners' Remuneration	30,00,000	
Royalty paid to Partner X **(Note 4)**	5,00,000	43,02,000
		53,02,000
Less: Interest on income-tax refund **(Note 8)**		1,20,000

Book Profit		**51,82,000**
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		
On first ₹3,00,000 90%	2,70,000	
On the balance ₹48,82,000 60%	29,29,200	
	31,99,200	
(ii) Remuneration actually paid or payable (₹ 1,00,000 × 10 months × 3 partners) + (Royalty ₹ 5 Lacs)		
(i) or (ii) whichever is less, is deductible	35,00,000	31,99,200
		19,82,800
Capital Gain		
Short-term capital gain on transfer of land **(Note 9)**		6,00,000
Income from other sources		
Interest on income-tax refund		1,20,000
Gross Total Income		**27,02,800**
Deductions under Chapter VI-A		Nil
Total Income		**27,02,800**

Notes:

1. As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Excess interest @ 3% paid from 1st June, 2019 to 31st March, 2020 is to be disallowed. Excess interest of 3% being ₹ 15,00,000 x 3/15 = ₹ 3,00,000.

2. Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC).

3. As per Explanation 1 to section 40(b), where an individual is a partner in a firm in representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Z represents his HUF in the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of ₹ 5 Lacs paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.

5. Section 40A(3) provides for disallowance of any expenditure in respect of which the actual payment exceeding ₹ 10,000 is made otherwise than by an account payee cheque, account payee bank draft or use of ECS through bank account or through such other electronic mode as may be prescribed in a single day to a person. Hence, the payments of ₹ 18,000 and ₹ 15,000 in cash on 1.2.2020 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of ₹ 33,000 exceeds the limit of ₹ 10,000.

The payment of bill of the assistant cameraman of ₹ 19,000 on 1st February is also liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has exceeded ₹10,000.

6. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid on or before the due date specified under section 139(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2020 has to be deposited latest by 31st July 2020/ 30th September, 2020 (as the case may be). The firm has paid the tax on 3rd June, 2020 and hence, the remuneration shall be allowed. Since the same is already debited to profit and loss account, no further adjustment is made.

7. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, gratuity of ₹ 1.50 lacs paid to retired employees is allowable as deduction. Hence, the balance provision of ₹ 4.50 lacs (i.e., ₹ 6 lacs – ₹ 1.50 lacs) is to be disallowed.

8. Interest on income-tax refund is assessable under the head "Income from other sources".

9. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words "or otherwise" includes within its scope, cases of distribution of capital assets on retirement of a partner also. [CIT vs. A. N. Naik Associates (2004) 265 ITR 346 (Bom.)]. Therefore, distribution of a plot of land on retirement of a partner would attract section 45(4).

   ₹ 16 lacs, being the fair market value of the plot on the date of transfer, is deemed to be the full value of consideration. Therefore, the short-term capital gain would be ₹ 6 lacs (i.e., ₹ 16 lacs – ₹10 lacs).

Question 21

PQR LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2015-16 for production of washing machines. The unit fulfills all the conditions of section 10AA of the Income-tax Act, 1961. During the financial year 2018-19, it has also set up a warehousing facility in a district of Tamil Nadu for storage of agricultural produce. It fulfills all the conditions of section 35AD. Capital expenditure in respect of warehouse amounted to ₹ 75 lakhs (including cost of land ₹ 10 lakhs). The warehouse became operational with effect from 1st April, 2019 and the expenditure of ₹ 75 lakhs was capitalized in the books on that date.

Relevant details for the financial year 2019-20 are as follows:

Particulars	₹
Profit of unit located in SEZ	40,00,000
Export sales of above unit	80,00,000
Domestic sales of above unit	20,00,000
Profit from operation of warehousing facility (before considering deduction under Section 35AD).	1,05,00,000

Compute income tax (including AMT under Section 115JC) payable by PQR LLP for Assessment Year 2020-21.

Answer

Computation of total income and tax liability of PQR LLP for A.Y.2020-21 (under the regular provisions of the Income-tax Act, 1961)

Particulars	₹	₹
Profits and gains of business or profession		
Unit in SEZ	40,00,000	
Less: Deduction under section 10AA **[See Note (1) below]**	32,00,000	
Business income of SEZ unit chargeable to tax		8,00,000
Profit from operation of warehousing facility	1,05,00,000	
Less: Deduction under section 35AD **[See Note (2) below]**	65,00,000	
Business income of warehousing facility chargeable to tax		40,00,000
Total Income		**48,00,000**
Computation of tax liability (under the normal/ regular provisions)		
Tax @ 30% on ₹ 48,00,000		14,40,000
Add: Health and Education cess @ 4%		57,600
Total tax liability		**14,97,600**

Computation of adjusted total income of PQR LLP for levy of Alternate Minimum Tax

Particulars	₹	₹
Total Income (as computed above)		**48,00,000**
Add: Deduction under section 10AA		32,00,000
		80,00,000
Add: Deduction under section 35AD	65,00,000	
Less: Depreciation under section 32		
On building @ 10% of ₹ 65 lakhs[8]	6,50,000	58,50,000
Adjusted Total Income		**1,38,50,000**
Alternate Minimum Tax @ 18.5%		25,62,250
Add: Surcharge @ 12% (since adjusted total income > ₹ 1 crore)		3,07,470
		28,69,720
Add: Health and Education cess @ 4%		1,14,789
		29,84,509
Tax liability under section 115JC (rounded off)		**29,84,510**

Since the regular income-tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @ 18.5% thereof plus surcharge @ 12% and cess @ 4%. Therefore, the tax liability is ₹ 29,84,510.

AMT Credit to be carried forward under section 115JEE

	₹
Tax liability under section 115JC	29,84,510
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	14,97,600
	14,86,910

Notes:

(1) **Deduction under section 10AA in respect of Unit in SEZ = 40lacs*80lacs/1cr = 32lacs**

(2) Deduction @ 100% of the capital expenditure is available under section 35AD for A.Y.2020-21 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2012.

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction during the previous year in which he commences operations of his specified business if the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction under section 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of ₹ 65 lakhs (i.e., ₹ 75 lakhs – ₹ 10 lakhs, being expenditure on acquisition of land) has been incurred in the F.Y.2018-19 and capitalized in the books of account on 1.4.2019, being the date when the warehouse became operational, ₹ 65,00,000, being 100% of ₹ 65 lakhs would qualify for deduction under section 35AD.

Question 22

Victory Polyfibres, a partnership firm, has earned a gross total income of ₹ 300 lacs for the year ended 31-3-2020. The firm has not undertaken any international transaction or specified domestic transaction during the said year.

The above includes a profit of ₹ 220 lacs from an undertaking having a turnover of ₹ 80 crores. This is the fifth year and deduction under section 80-IA of the Income-tax Act, 1961 is available to the extent of ₹ 200 lacs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7-12-2020, after seeking clarifications from tax experts.

Advise the assessee-firm by working out the total income and tax payable, where the return is filed on 30-09-2020 or when the same is filed on 7-12-2020.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income? You may ignore interest under section 234A, 234B, 234C and 234F while making the computation in support of your advice.

Answer

As per section 80AC, while computing the total income of an assessee of a previous year **(P.Y.2019-20, in this case)** relevant to any assessment year **(A.Y.2020-21, in this case)**, any deduction is admissible, inter alia, under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the 'due date' specified in section 139(1).

Since the turnover of the partnership firm has exceeded ₹ 200 lacs in the previous year 2019-20, it would be subject to audit under section 44AB, in which case the 'due date' of filing its return of income for A.Y.2020-21 would be 30th September, 2020 as per section 139(1).

Computation of total income and tax liability of M/s. Victory Polyfibres for A.Y.2020-21

I. Where the firm files its return of income on 30th September 2020:

Particulars	₹ in lacs
Gross Total Income	300.00

Less: Deduction under section 80-IA	200.00
Total Income	**100.00**
Tax liability @ 30%	30.00
Add: Health and Education cess @ 4%	1.20
Regular income-tax payable	**31.20**

Computation of Alternate Minimum Tax payable [Section 115JC]

Particulars	₹ in lacs
Total Income	100.00
Add: Deduction under section 80-IA	200.00
Adjusted Total Income	**300.00**
Alternate Minimum Tax (AMT) @ 18.5% on ₹ 300 lacs	55.50
Add: Surcharge @ 12% (Since adjusted total income >₹ 1 crore)	6.66
	62.16
Add: Health and Education cess @ 4%	2.49
Total tax payable (AMT)	**64.65**

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2019-20 and it shall be liable to pay income-tax on such total income @ 18.5% **[Section 115JC(1)]**. Therefore, the tax payable for the A.Y.2020-21 would be ₹ 64.65 lacs.

Tax credit for Alternate Minimum Tax [Section 115JD]

	₹ in lacs
Total tax payable for A.Y.2020-21 (Alternate Minimum Tax)	64.65
Less: Regular income-tax payable	31.20
To be carried forward for set-off against regular income-tax payable (upto a maximum of fifteen assessment years).	33.45

II. Where the firm files its return of income on 7th December 2020:

Where the firm files its return on 7-12-2020, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IA would not be available. In such circumstances, the gross total income of ₹ 300 lacs would be the total income of the firm.

Particulars	₹ in lacs
Income-tax @ 30% of ₹ 300 lacs	90.000
Add: Surcharge @ 12% (since total income exceeds ₹ 100 lacs)	10.800
Income-tax (plus surcharge)	100.800
Add: Health and Education cess @ 4%	4.032
Total tax liability	**104.832**

Practical solution regarding obtaining clarifications

The practical solution regarding obtaining clarifications would be to file the return of income under section 139(1) on or before the 'due date', i.e., 30.9.2020, and claim deduction under section 80-IA. In such a case, the firm can claim deduction of ₹ 200 lacs under section 80- IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return

under section 139(5) within 31.3.2021 (i.e., within the end of A.Y.2020-21) which would replace the original return filed under section 139(1). A revised return filed under section 139(5) would replace the original return filed under section 139(1).

If the firm files the return of income under section 139(1) on or before 30.9.2020, its tax liability would stand reduced to ₹ 64.65 lacs, as against ₹ 104.832 lacs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of ₹ 33.45 lacs. Therefore, the firm is advised to file its return of income on or before 30.9.2020.

Question 23

Prakash, a member in two AOPs, namely, "AOP & Co." and "Prakash & Akash", provides the following details of his income for the year ended 31.3.2020:

(a) "AOP & Co.", assessed at normal rates of tax, had credited in his account, amount of ₹ 2,10,000 as interest on capital, ₹ 4,96,000 as salary and ₹ 20,000 as share of profit.

(b) A house property located at Jaipur was purchased on 1.7.2010 with the borrowed capital in "Prakash & Akash" jointly shared equally and occupied by both of them for self-residential purposes. Total interest paid for the year 2019-20 on the borrowed capital was ₹ 4,10,000.

Compute the income and the tax liability thereon for the A.Y. 2020-21 and support your answer with brief reasons and the provisions of the Act.

Answer

Mr. Prakash is a member in two AOPs, namely, AOP & Co. and Prakash & Akash. Though Prakash & Akash is an AOPs, the income from the house property will not be assessed as income of the AOPs, but will be included in the hands of the individual members as per section 26, since the share of each member is definite and ascertainable. Hence, Prakash's share of income from house property would be assessed in his individual hands.

Since AOP & Co., has been taxed at normal rates of tax, Mr. Prakash's share income from the AOPs (i.e. salary, interest on capital and his share of profit) would be included in his total income. Mr. Prakash, however, would be entitled to a relief under section 86 read with section 110 in respect of this income which has been included in his total income but on which tax has already been paid by the AOPs. As per section 110, the relief shall be allowed at the average rate of tax calculated on the total income inclusive of such income.

Hence, the tax liability in the hands of Mr. Prakash would be as under:-

Particulars	₹	₹
Annual Value (½ share in house property used for own residence);	Nil	
Less: Interest on loan [½ share in ₹ 4,10,000] – Since the loan is borrowed on or after 1.4.1999 and is used for acquiring property within 5 years, deduction would be available upto a maximum of ₹ 2,00,000. This limit of ₹ 2,00,000 applies for each member separately.	2,00,000	
Loss from house property		(2,00,000)
Share income from AOP & Co.		
- Interest on capital	2,10,000	
- Salary	4,96,000	
- Share of profit	20,000	7,26,000

Total Income		**5,26,000**

Particulars		₹
Tax on ₹ 5,26,000	3.5%	17,700
Add: Health and Education Cess @ 4%		708
Tax Liability		18,408
Less: Rebate under section 86 read with section 110 = ₹ 18,408 x 100/₹5,26,000		
Rebate available ₹ 7,26,000 x 3.5% = ₹ 25,410		
Restricted to		18,408
Tax payable		**Nil**

Question 24

T and Q are individuals, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March, 2020, the Profit and Loss account of the business was as under:

		Figures are in ₹ '000s	
Cost of goods sold	4,250	Sales	4,900
Remuneration to:		Dividend from Indian companies	25
T	130	Capital gains-Long term (computed)	640
Q	170		
Employees	256		
Interest to:			
T	48.3		
Q	35.7		
Other expenses	111.7		
Sales-tax penalty due	39		
Net profit	524.3		
	5,565		**5,565**

Additional information furnished:

(i) Other expenses included:
  (a) wrist watches costing ₹ 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;
  (b) employer's contribution of ₹ 6,000 to the Provident Fund was paid on 14th January, 2020.
  (c) ₹ 30,000 was paid in cash to an advertising agency for publicity.

(ii) Outstanding sales tax penalty was paid on 15th October, 2020. The penalty was imposed by the Sales-tax Officer for non-filing of returns and statements by the due dates.

T and Q had, for this year, income from other sources of ₹ 3,60,000 and ₹ 2,32,000 respectively.

Required to:

(i) Compute the total income of the AOPs for the assessment year 2020-21; and
(ii) Discuss the tax implication for that year in the hands of the individual members.

Answer

(i) Computation of total income of the AOP for A.Y.2020-21

Particulars	₹
Profit & gains of business **(See Working Note below)**	3,12,300
Long term capital gain	6,40,000
Income from other sources [Dividend is exempt under section 10(34)]	-
Total income	9,52,300

Working Note - Computation of profits and gains of business

Particulars	₹	₹
Net profit as per profit & loss account		5,24,300
Add: Inadmissible payments		
Interest to members T & Q (₹ 48,300 + ₹ 35,700)	84,000	
Advertising [Disallowance under section 40A(3) (100% of ₹ 30,000 being a cash payment)]	30,000	
Remuneration to members T & Q (₹ 1,30,000 +₹ 1,70,000)	3,00,000	
Sales tax penalty **(See Note 3 below)**	39,000	4,53,000
		9,77,300
Less: Income not taxable under this head		
Dividend from Indian companies	25,000	
Long term capital gain	6,40,000	6,65,000
Profits and gains of business		**3,12,300**

Notes:

1. Since the employer's contribution to PF has been paid during the previous year itself, it is allowable as deduction.

2. Penalty imposed for delay in filing sales tax return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – CIT v. Ratanchand Bholanath (S.S) (1986) 160 ITR 500 (M.P.)

(ii) Tax implication in the hands of members T & Q for the A.Y.2020-21

Members of the AOPs have to pay tax on their total income taking into account savings/ investments etc.

Since one of the members has individual income more than the basic exemption limit, the AOPs will be assessed at the maximum marginal rate.

Since the AOPs is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually.

Question 25

The assessee, Pandey Co-operative Housing Society, is a registered co-operative housing society, formed with the objective of maintaining the property owned by it, to effect repairs and maintenance of the common property of the members, and to confer to the members, the usual rights and privileges. For the assessment year 2020-21, the assessee has received ₹ 3 lacs as transfer fees from the transferor members and like amount from the transferees, who at the time of transfer, were not members of the society. Discuss the exigibility to tax the aforesaid receipts in the hands of the assessee.

Answer

Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality where the predominant activity of such co-operative society is maintenance of property of the society. It was so held by the Bombay High Court in Sind Co-op Housing Society v. ITO (2009) 317 ITR 47.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Therefore, ₹ 3 lacs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.

Section B – Additional Questions

Question 26

Tarun Shipping Co. Ltd., having its registered office in Mumbai, plies two ocean-going vessels which it owns. The registered tonnage of the two vessels are 47,516 tonnes and 200 kgs and 25,759 tonnes and 400 kgs respectively. In the accounting year 2019-20, the first vessel was operated for 360 days and the second for 200 days.

The accounts of the company reveal the following results:

(i) Profit from core shipping activity ₹ 90.50 Lacs

(ii) Profit from incidental activity ₹ 15,000

Compute the tax payable by the company for the assessment year 2020-21, taking note of the provisions of the law relating to taxation of income of shipping companies. Also indicate the specified conditions for the applicability of the procedure.

Answer

Computation of tax payable by Tarun Shipping Company Ltd. for the A.Y.2020-21

Particulars	₹
Tonnage income (See Working Note below)	89,86,600
Tax @ 30%	26,95,980
Add: Surcharge (Not applicable as the income is below ₹ 100 Lacs)	Nil
	26,95,980
Add: Education cess @ 4%	1,07,839
Total tax payable	**28,03,819**

Working Note

Since the income under tonnage tax scheme is lower than the normal income of ₹ 90.50 Lacs, the tonnage tax scheme is taken for computing tax payable.

Computation of Tonnage Income [Section 115VG]

Particulars	Ship I ₹	Ship 2 ₹
First 1,000 tons (1000 x 70/100)	700	700
Next 9,000 tons (9,000 x 53/100)	4,770	4,770
Next 15,000 tons (15,000 x 42/100)	6,300	6,300
Balance [(22,500/800) x 29/100]	6,525	232
	18,295	**12,002**

Tonnage income	₹
Ship 1 (18,295 X 360)	65,86,200
Ship 2 (12,002 X 200)	24,00,400
	89,86,600

Note: Tonnage is to be rounded off to the nearest multiple of 100 tons. Hence, the first vessel will pay for 47,500 tons and the second for 25,800 tons.

As per section 115VF, the tonnage income computed under section 115VG would be deemed to be the profits chargeable under the head "Profits and gains of business or profession". This is, however, subject to fulfillment of the conditions mentioned below in the next paragraph. Then, the relevant shipping income referred to in section 115-VI(1), which includes the profit from core shipping activity (i.e. ₹ 90.50 Lacs) and the profit from incidental activity (₹ 15,000), shall not be

chargeable to tax.

The following are the conditions to be fulfilled by the company for applicability of the tonnage tax scheme -

(i) An option to get assessed under Chapter XII-G has to be filed by the company.

(ii) The company is required to credit to a reserve account called Tonnage Tax Reserve Account, at least 20% of the book profits derived from its core and incidental activities to be utilized before the expiry of a period of 8 years for acquisition of a new ship for the purposes of the business of the company. Until the acquisition of a new ship, the amount can be utilized for the purposes of the business of operating qualifying ships. However, the amount should not be used for distribution of dividends or profits or for remittance outside India as profit or for creation of assets outside India.

Question 27

Mysore Co-operative Society derives income during financial year 2019-20 from the following sources:

(i)	Income from processing with the aid of power	₹ 40,000
(ii)	Income from collective disposal of labour of its members	₹ 20,000
(iii)	Interest from another co-operative society	₹ 12,000
(iv)	Income from house property (Computed)	₹ 75,000
(v)	Income from other business	₹ 72,000
(vi)	Income by way of dividend from another co-operative society	₹ 15,000

Determine the total income of Mysore Co-operative Society for the A.Y. 2020-21.

Answer

Computation of total income of Mysore Co-operative Society for A.Y.2020-21

Particulars		₹	₹
I	**Income from house property**		75,000
II	**Profits and Gains of Business or Profession**		
	From processing with the aid of power	40,000	
	From collective disposal of labour	20,000	
	From other business	72,000	
			1,32,000
III	**Income from Other Sources**		
	Interest received from another co-operative society	12,000	
	Dividend received from another co-operative society	15,000	
			27,000
Gross Total Income			**2,34,000**
Less: Deduction under section 80P			
	Interest and dividend from another co-operative society [₹ 12,000 + ₹ 15,000] - fully deductible under section 80P(2)(d)	27,000	
	Income from collective disposal of labour – fully deductible under section 80P(2)(a)(vi), assuming that the stipulated conditions are fulfilled.	20,000	
	Income from other business ₹ 72,000, deduction restricted to ₹ 50,000 under section 80P(2)(c)(ii)	50,000	
			97,000

Total Income		**1,37,000**

Note: Since the gross total income exceeds ₹ 20,000, in case of a co-operative society engaged in manufacturing operations with the aid of power, income from house property is not eligible for deduction under section 80P(2)(f)

Question 28

Anustup Chandra Flour Mills Ltd., a domestic company engaged in manufacture of wheat flour, furnishes the following information pertaining to the year ended 31-3-2020:

(i) Net profit as per the Statement of Profit and Loss is ₹ 77 lakhs after considering the items listed in (ii) to (vi) below.

(ii) The company is a member of Vishnu Foods & Co., an AOP in which the members' shares are determinate and their shares in profit/loss are clearly known. The entire income of the AOP is from business activities. During the year, the company has derived share income of ₹ 9 lakhs from the AOP. The company has spent a sum of ₹ 90,000 towards earning such income.

(iii) The company has provided for income-tax (including interest under sections 234B and 234C of ₹ 62,000) for ₹ 3 lakhs and ₹ 5 lakhs towards share in loss of foreign subsidiary.

(iv) Amount debited to the Statement of Profit and Loss towards interest to a public financial institution is ₹ 12 lakhs. Of this, ₹ 4 lakhs was paid on 12-12-2019 only.

(v) The company committed breach of building norms while extending the factory building. The City Corporation initiated proceedings against the company and the company settled the issue by paying compounding fee of ₹ 1 lakh. This amount forms part of general expenses, which has been debited to the Statement Profit and Loss.

(vi) In the administrative expenses, the company has debited a sum of ₹ 70,000 towards fee for delayed filing of statement of TDS under section 234E of the Income-tax Act, 1961.

(vii) The company has credited revaluation surplus of ₹ 10 lakhs on fair valuation of assets under Ind AS 16 and Ind AS 38 to other equity.

(viii) The company has credited ₹ 5 lakhs to other comprehensive income on fair valuation of equity instruments in which the company has Investment.

During the current year, the depreciation charged as per books of account of the company is the same as allowable under the Income-tax Act, 1961 [before considering the provisions of section 32(2)]. The company proposes to adopt this practice consistently in the future years.

You are required to compute the income-tax payable by the company for the assessment year 2020-21. The company is an Indian Accounting standard compliant company.

Note: The Turnover of company for the P.Y 2017-18 was ₹ 350 crore.

Answer

Computation of Total Income of Anustup Chandra Flour Mills Ltd. as per the normal provisions of the Act for A.Y. 2020-21

Particulars	₹	₹
Net Profit as per statement of profit and loss		77,00,000
Add: Items debited but to be considered separately or to be disallowed/ amount taxable but not credited	90,000	
(ii) Expenditure on earning share income in AOP		
[Share income in AOP, which pays tax at the maximum marginal rate is exempt in the hands of the member. Consequently, expenditure incurred on earning exempt income		

is not allowable as deduction. Since the same has been debited in the statement of profit and loss, it has to be added back]		
(iii) Provision of income-tax(including interest u/s 234B and 234C) [Provision of income-tax is not allowable as deduction. Also, any interest payable for default committed by the assessee for discharging his statutory obligations under Income-tax Act, 1961 which is calculated with reference to the tax on income is not allowable as deduction. Since the provision and interest have been debited to statement of profit and loss, they have to be added back]	3,00,000	
(iii) Provision for loss of foreign subsidiary [Since the loss of foreign subsidiary is not a loss incurred for the purpose of business of the assessee, it is not allowed while computing business income. Since the same has been debited in the statement to profit and loss, it has to be added back]	5,00,000	
(iv) Interest to a public financial institution [Deduction of any sum, being interest payable on any loan or borrowing from a public financial institution shall be allowed, if such interest has been actually paid. Since ₹4 lakhs has been paid on 12.12.2019, the balance ₹8 lakhs debited to statement of profit and loss has to be added back, assuming that such sum is not paid on or before due date of filing of return of income]	8,00,000	
(v) Compounding fee paid for violation of building norms [The amount paid for compounding an offence is inevitably a penalty and the mere fact that it has been described as compounding fee cannot, in any way, alter the character of the payment which is in the nature of penalty. Hence, the same is not allowable as revenue expenditure. Since the same has been debited to statement of profit and loss, it has to be added back]	1,00,000	
(vi) Fee for delayed filing of statement of TDS [Under section 37, any expenditure incurred wholly and exclusively for the purpose of business or profession is allowed as deduction. The fee for delayed submission of the statement of TDS is not in the nature of interest for delayed remittance of TDS or in the nature of penalty, which are not allowable as deduction while computing business income. Hence, it is allowable as deduction. Since the same has been debited to statement of profit and loss, no further adjustment is required]	-	
(vii) Revaluation surplus on fair valuation of assets under Ind AS 16 and 38 credited to other equity [No treatment is required under the regular provisions of the Income-tax Act, 1961. Since the same has not been credited to statement of profit and loss, no adjustment is required]	-	
(viii) Fair valuation of equity instruments	-	

[No treatment is required under the regular provisions of the Income-tax Act, 1961. Since the same has not been credited to statement of profit and loss, no adjustment is required]		17,90,000
		94,90,000
Less: Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances		
(ii) Share income in AOP		9,00,000
[Where a company is a member in an AOP, the AOP would have to pay tax at the maximum marginal rate owing to which, company's share in the total income of AOP will not be included in its total income and will be exempt. Since the same has been credited to the statement of profit and loss, the same has to be reduced while computing business income]		
Total income		**85,90,000**

Computation of book profit under section 115JB for A.Y. 2020-21

Particulars	₹	₹
Net profit as per the statement of profit and loss		77,00,000
Add: **Net profit to be increased by the following amounts as per Explanation 1 to section 115JB(2):**		
(ii) **Expenditure on earning share income in AOP**	90,000	
[Expenditure related to share income in AOP has to be added back while computing the book profit, since no income-tax is payable by the companyon share income in AOP]		
(iii) **Provision of income-tax(including interest under section 234B and 234C)**	3,00,000	
[Income-tax shall include, inter alia, any interest charged under the Act, therefore, whole of the amount of provision for income-tax including ₹ 62,000 towards interest payable has to be added]		
(iii) **Provision for loss of foreign subsidiary**	5,00,000	8,90,000
[Provision for losses of subsidiary companies has to be added back]		
		85,90,000
Less: **Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB(2):**		
(i) Share income in AOP		9,00,000
[Share income of company in AOP has to be reduced while computing the book profit, since no income-tax is payable by the companyon share income in AOP]		
Book profit computed in accordance with Explanation 1 to section 115JB(2)		76,90,000
Add: Items credited to OCI that will not be reclassified to profit or loss:		
(vii) **Revaluation surplus** on fair valuation of assets ₹ 10 lakhs [Book profit not to be increased by revaluation surplus for assets]		-

(viii) **Income on fair valuation of equity instruments** of ₹ 5 lakhs [Book profit not to be increased by income in fair values of equity instruments]		-
Book Profit for levy of MAT		**76,90,000**

Computation of tax liability for A.Y. 2020-21

Particulars	₹
Minimum Alternate Tax on book profit under section 115JB = 15% of ₹ 76,90,000	11,53,500
Income-tax computed as per the normal provisions of the Act [₹ 85,90,000 x 25% since, the turnover of the company for the P.Y. 2017-18 does not exceed ₹ 400 crores]	21,47,500
Since the income-tax liability of ₹ 21,47,500 is higher than the MAT liability of ₹ 11,53,500, the income-tax liability would be computed as per the normal provisions of the Income-tax Act,1961:	
Income-tax computed as per the normal provisions of the Act	21,47,500
Add: Education cess 4%	85,900
Tax Payable	**22,33,400**
Tax Payable (rounded off)	**22,33,400**

Note - The number used in the computation are not the serial number but are the number of each of the adjustment or of additional information given there against in the question.

Question 29

Alpha and Beta Tyres Limited, an Indian Company engaged in the manufacture of Tyres in Andhra Pradesh, has adopted IndAS from 1-4-2017. The following particulars are provided for the year ended 31.3.2020 :

Net profit as per statement of profit and loss is ₹ 20 crores after debit and credit of the following items:

Items Debited:

(i) Depreciation ₹ 18 crores. Included in depreciation is ₹ 3 crores, being amount provided on revalued assets.

(ii) Interest charged for delay in remittance of tax deducted at source ₹ 20 lakhs.

Items Credited:

(i) Share Income from Association of Persons in which the company is a member ₹ 50 lakhs. (The AOP is charged to tax at Maximum Marginal Rate)

(ii) Amount of ₹ 6 crores withdrawn from revaluation reserves on account of revaluation of assets.

Other Information:

1. The application of a financial creditor for corporate insolvency resolution process has been admitted by the Hyderabad Bench of the National Company Law Tribunal under section 7 of the Insolvency and Bankruptcy Code, 2016.

2. Brought forward business loss and depreciation.

Assessment Year	Business Loss	Depreciation
2016-17	₹ 3 crores	₹ 1 crore
2017-18	₹ 5 crores	₹ 2 crores

3. Items credited to other comprehensive income which will not be reclassified to profit or

loss:

(i) Re-measurement of defined employee retirement benefits plan ₹ 50 lakhs.

(ii) Revaluation surplus of property, plant and equipment ₹ 1 crore.

4. The transition amount as on convergence date 1-4-2017 stood at ₹ 5 crores including capital reserve of ₹ 50 lakhs (credit balance).

5. Tax payable under the regular provisions of the Income-tax Act, 1961 is ₹ 0.73 crores.

(i) Compute Minimum Alternate Tax payable by the company for the Assessment Year 2020-21.

(ii) Compute the amount of MAT credit eligible for carried forward.

Answer

Computation of MAT payable by Alpha and Beta Tyres Limited under section 115JB for A.Y.2020-21

Particulars	₹	₹
Net profit as per statement of profit and loss		20,00,00,000
Add: **Net profit to be increased by the following amounts as per Explanation 1 to section 115JB(2):**		
- Depreciation	18,00,00,000	
- Interest charged for delay in remittance of TDS	20,00,000	
[As per Explanation 2 to section 115JB, income- tax shall include, inter alia, any interest charged under the Act. Therefore, interest on delay in remittance of TDS has to be added back]		18,20,00,000
		38,20,00,000
Less: **Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB(2):**		
- Depreciation other than depreciation on revaluation of assets [₹18 crore – ₹3 crore]	15,00,00,000	
- Share income from Association of Persons	50,00,000	
[Share income of company in AOP has to be reduced while computing the book profit, since no income-tax is payable by the company on share income in AOP, as the AOP is chargeable to tax at Maximum Marginal Rate]		
- Amount withdrawn from revaluation reserve [₹ 6 crore] to the extent it does not does not exceed depreciation on revaluation of assets [₹3 crore]	3,00,00,000	
- Brought forward business loss of ₹ 8 crore [₹ 3 crore + ₹ 5 crore] and unabsorbed depreciation of ₹3 crore [₹1 crore + ₹2 crore]	11,00,00,000	
[Since Alpha and Beta Tyres Limited is a company against which an application for corporate insolvency resolution process has been admitted by NCLT under section 7 of the Insolvency and Bankruptcy Code, 2016, the amount of total loss brought forward (including unabsorbed depreciation) is allowed to be reduced from the book profit for the purposes of levy of MAT under section 115JB].		29,50,00,000

Book profit computed in accordance with Explanation 1 to section 115JB(2)		8,70,00,000
Add: **Items credited to OCI that will not be reclassified to profit or loss:**		
Re-measurement of defined employee benefit plan	50,00,000	
Revaluation surplus of property, plant and equipment ₹ 1 crore [Book profit not to be increased by revaluation surplus for assets]	Nil	
		50,00,000
		9,20,00,000
Add: **One-fifth of Transition amount [Credit Balance]**		
Transition amount	5,00,00,000	
Less: **Amounts to be excluded from transition amount**		
Capital Reserve	50,00,000	
	4,50,00,000	
One-fifth of ₹4,50,00,000		90,00,000
Book Profit for levy of MAT		**10,10,00,000**

Computation of MAT	**₹**
MAT on book profit under section 115JB = 15% of ₹10,10,00,000	1,51,50,000
Add: Surcharge@12% (since book profit exceeds ₹10 crore)	18,18,000
	1,69,68,000
Add: Health and education cess@4%	6,78,720
MAT liability for A.Y.2020-21	**1,76,46,720**

Computation of MAT credit to be carried forward

Particulars	**₹**
MAT liability for A.Y.2020-21 (rounded off)	1,76,46,720
Income-tax computed as per the normal provisions of the Act for A.Y.2020-21	73,00,000
Since the income-tax liability computed as per the regular provisions of the Income-tax Act,1961 is less than the MAT payable, the book profit of ₹ 10,10,00,000 would be deemed to be the total income and tax is leviable@15%: The total tax liability (rounded off) is ₹1,76,46,720.	
Computation of tax credit to be carried forward:	
Tax payable for A.Y.2020-21 on deemed total income	1,76,46,720
Less: Income-tax payable as per the normal provisions of the Act	73,00,000
Tax credit in respect of tax paid on deemed income	**1,03,46,720**

Question 30

Godavari Ltd., an Indian Company engaged in manufacture and sale of electrical appliances in India and abroad, started adoption of Ind AS with effect from 1st April, 2018. The following particulars are furnished for the year ended 31st March, 2020:-

(a) The book profit after adjustment of all items specified in section 115JB(2) amounted to ₹ 87.34 lakhs (except the adjustment for brought forward losses/ unabsorbed depreciation), for the year ended 31.3.2020.

(b) Brought forward losses as per books are as under : (₹ In lakhs)

Financial Year	**Business loss**	**Depreciation**

2017-18	8.20	7.60
2018-19	7.30	9.50

(c) The particulars of "Other Comprehensive Income" for the year ended 31.03.2020: (₹ In lakhs)

Other Comprehensive Income (OCI) that will not be re- classified to profit and loss:		**Debit**	**Credit**
(i)	Deferred costs of hedging	3.80	
(ii)	Changes in fair values of equity instruments	8.00	
(iii)	Revaluation surplus for assets		8.20
(iv)	Deferred gains on cash flow hedges		6.70
(v)	Re-measurement of post-employment benefit obligations		5.20
(vi)	Share of other comprehensive income of other associates		2.80
Other Comprehensive Income (OCI) that may be re- classified to profit and loss:		**Debit**	**Credit**
(i)	Deferred gains on cash flow hedges		8.20
(ii)	Comprehensive income from discontinued operations		5.30
(iii)	Exchange Differences of foreign exchange operations	1.80	
(iv)	Deferred costs of hedging	0.80	

(d) The transition amount as on convergence date (01-04-2018) stood at ₹ 48 lakhs (credit balance) including capital reserve of ₹ 6 lakhs and adjustment of ₹ 5 lakhs relating to translation difference in a foreign operation.

(e) The National Company Law Tribunal (NCLT), Mumbai Bench has admitted an application under section 7 of Insolvency and Bankruptcy Code, 2016 (IBC) made by financial creditor against the company for initiation of Corporate Insolvency Resolution Process on 30th March, 2020.

You are required to compute the MAT liability for the assessment year 2020-21, applying the provisions relating to Ind AS compliant companies. Assuming that the income tax under normal provisions of Income-tax Act, 1961 for the assessment year 2020-21 works out to ₹ 10.20 lakhs, compute the tax credit, if any, to be carried forward by the company including the period up to which it will be available to be carried forward.

Answer

Computation of MAT liability of Godavari Ltd. under section 115JB for A.Y.2020-21

Particulars	**₹**	**₹**
Book profit after adjustment of items under section 115JB(2) [except brought forward business loss and unabsorbed depreciation]		87,34,000
Less: Brought forward business loss [₹ 8,20,000 + ₹ 7,30,000]	15,50,000	
Unabsorbed depreciation [₹ 7,60,000 + ₹ 9,50,000]	17,10,000	
[Since Godavari Ltd. is a company against which an application for corporate insolvency resolution process has been admitted by NCLT under section 7 of the Insolvency and Bankruptcy Code, 2016, the amount of total loss brought forward (including unabsorbed depreciation) is allowed to be reduced from the book profit for the purposes of levy of MAT under section 115JB].		32,60,000

Book profit computed in accordance with Explanation 1 to section 115JB(2)		54,74,000
Add: **Items credited to OCI that will not be reclassified to profit or loss:**		
Deferred gains on cash flow hedges	6,70,000	
Share of Other Comprehensive Income of Other Associates	2,80,000	
Re-measurement of post-employment benefit obligations	5,20,000	
Revaluation surplus for assets ₹ 8,20,000 [Book profit not to be increased by revaluation surplus for assets as per proviso to section 115JB(2A)]	Nil	
		14,70,000
		69,44,000
Less: **Items debited to OCI that will not be reclassified to profit or loss:**		
Deferred costs of hedging	3,80,000	
Changes in fair values of equity instruments ₹ 8,00,000 [Book profit not to be decreased by changes in fair values of equity instruments as per proviso to section 115JB(2A)]	Nil	3,80,000
		65,64,000
Add: **One-fifth of Transition amount [Credit Balance]**		
Transition amount	48,00,000	
Less: Amounts to be excluded from above		
Capital Reserve	6,00,000	
Translation difference in foreign operations	5,00,000	
	37,00,000	
One-fifth of ₹ 37,00,000		7,40,000
Book Profit for levy of MAT		**73,04,000**
MAT on book profit under section 115JB = 15% of ₹ 73,04,000		10,95,600
Add: Health and education cess@4%		43,824
MAT liability for A.Y.2020-21		**11,39,424**
MAT liability for A.Y.2020-21 (rounded off)		**11,39,420**

Computation of tax credit to be carried forward

Particulars	₹
MAT liability for A.Y.2020-21 (rounded off)	11,39,420
Income-tax computed as per the normal provisions of the Act for A.Y.2020-21	10,20,000
Since the income-tax liability computed as per the regular provisions of the Income-tax Act,1961 is less than the MAT payable, the book profit would be deemed to be the total income and tax is leviable @15%: The total tax liability (rounded off) is ₹ 11,39,420.	
Computation of tax credit to be carried forward	
Tax payable for A.Y.2020-21 on deemed total income	11,39,420
Less: Income-tax payable as per the normal provisions of the Act	10,20,000
Tax credit in respect of tax paid on deemed income	**1,19,420**
[Can be carried forward for 15 Assessment Years i.e., upto A.Y.2035-36]	

Question 31

M/s ABC LLP is engaged in export of computer software from a Special Economic Zone. The net profit of the firm as per its Profit & Loss Account for the year ended 31-3-2020 was ₹ 250 lakhs after debit/credit of the following items:

(1) Depreciation ₹ 20 lakhs

(2) Remuneration to its working partners ₹ 200 lakhs

(3) Interest provided on the current account balance of the partners @ 15% p .a. ₹ 15 lakhs

(4) Advertisement in a souvenir published by a political party ₹ 2 lakhs

Additional Information:

(1) The firm commenced business on 1-4-2018.

(2) Depreciation allowable as per Income-tax Rules is ₹ 25 lakhs.

(3) Payment of remuneration to working partners is authorized by the Partnership Deed. However Interest is not authorised by Deed.

(4) Brought forward business loss and depreciation from Assessment Year 2019-20 was ₹ 50 lakhs and ₹ 30 lakhs respectively.

(5) The total export turnover of the firm was ₹ 25 crores. Amount of export turnover realized within six months was ₹ 15 crores.

Compute the tax payable by the firm under section 115JC and the amount of tax credit allowed to be carried forward. Give working notes for your answer.

Answer

Computation of total income and tax liability of M/s ABC LLP for A.Y.2020-21 (under the regular provisions of the Income-tax Act, 1961)

Particulars	(₹ in lakhs)	(₹ in lakhs)
Profits and gains of business or profession		**250.00**
Add: Items debited but to be considered separately or to be disallowed		
- Depreciation	20.00	
- Remuneration to its working partners	200.00	
- Interest provided on the current account balance of the partners@15% p.a. (Interest on current account would be fully disallowed since the same is not authorized by the partnership deed) [See Note 2 for alternate answer].	15.00	
- Advertisement in a souvenir published by a political party [not allowed as deduction as per section 37(2B)]	2.00	**237.00**
Less: Permissible expenditure and allowances		**487.00**
- Depreciation allowable as per Income-tax Rules, 1962	25.00	
- Unabsorbed depreciation under section 32(2) [allowable as deduction while computing book profit as per Explanation 3 to section 40(b)]	30.00	55.00
Book Profit		**432.00**
On first ₹ 3 lakh of book profit [₹ 3,00,000 × 90%]	2.70	
On balance ₹ 429 lakh of book profit [₹ 429 × 60%]	257.40	

	260.10	
Remuneration actually paid of ₹ 200 lacs is fully allowable as deduction, since it is lower than the specified limit		**200.00**
Business Income		**232.00**
Less: Brought forward business loss for A.Y. 2019-20		50.00
Gross Total Income		**182.00**
Less: Deduction under section 10AA [See Note (1)]		182.00
Profit from SEZ unit x Export Turnover/ Total Turnover x 100% = ₹ 232 lakhs x 25 / 25 x 100% (since it is the second year of operation) = ₹232 lakhs, restricted to gross total income		
Less: Deduction under section 80GGC		-
[Expenditure on advertisement in a souvenir published by a political party not allowable as deduction since it is included within the meaning of the term "contribution" only for the purpose of deduction u/s 80GGB in case of a company.]		
Total Income		**Nil**
Tax liability (since total income is Nil)		**Nil**

Computation of adjusted total income of M/s ABC LLP for levy of Alternate Minimum Tax

Particulars	(₹ in lakhs)
Total Income (as computed above)	**Nil**
Add: Deduction under section 10AA	182.00
Adjusted Total Income	**182.00**
Alternate Minimum Tax@18.5%	33.6700
Add: Surcharge@12% (since adjusted total income > ₹ 1 crore)	4.0404
	37.7104
Add: Health and Education cess@4%	1.5084
Tax liability under section 115JC	**39.2188**
Since the regular income-tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @18.5% thereof plus surcharge@12% and cess@4%. Therefore, the tax liability is ₹ 39.2188 lakhs.	
AMT Credit to be carried forward under section 115JEE	
Tax liability under section 115JC	39.2188
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	Nil
Amount of Credit	**39.2188**

Notes:

(1) In the question, total export turnover of the firm is given as ₹ 25 crores and export turnover realised within six months is given as ₹ 15 crore. Erstwhile section 10A(3) specified a time limit of six months from the end of the previous year for remittance of export turnover. The definition of "export turnover" under section 10AA, however, does not mention any time limit within which the consideration has to be brought into India. Accordingly, the above solution has been worked out considering that balance ₹ 10 crore is received in India after the six month period, hence the export turnover and the total turnover would remain same i.e., ₹ 25 crore.

Alternatively, since export turnover and total export turnover are given separately in the question, the answer can also be worked out by taking export turnover as ₹ 15 crore, assuming that the balance ₹ 10 crore is not brought into India within the period of 9 months permitted by RBI. As per RBI Master Direction No. 16/2015-16 [RBI/FED/2015-16/11 FED] updated upto 12.1.2018, the period of realization and repatriation of export

proceeds shall be 9 months from the date of export for all exporters including Units in Special Economic Zones (SEZs).

In such case, the deduction available under section 10AA would be ₹ 139.20 lakh (₹ 232 lakhs x 15/25 x 100%). Accordingly, total income would be ₹ 42.80 lakhs and tax liability computed as per normal provisions of the Act would be ₹ 13.3536 lakhs. Consequently, the tax credit available under section 115JEE would be ₹ 25.8652 lakh.

Question 32

M/s. Beta & Co., a partnership firm in India, is engaged in development of software and providing IT enabled services through two units, one of which is located in a notified Special Economic Zone (SEZ) in Noida (commenced operations from 01.04.2008) and the other located in a domestic tariff area (DTA). The particulars relating to previous year 2019-20 furnished by the assessee are as follows:

Total Turnover: SEZ unit ₹ 210 lakhs; DTA unit ₹ 90 lakhs

Export Turnover: SEZ unit ₹ 150 lakhs; DTA unit ₹ 50 lakhs

Profit: SEZ unit ₹ 50 lakhs; DTA unit ₹ 40 lakhs.

Amount debited to Statement of Profit and Loss and credited to Special Economic Zone Re-Investment Reserve Account ₹ 20 lakhs.

Considering that the firm has no other income during the year, compute the tax payable by the firm for the A.Y.2020-21 by integrating, analysing and applying the relevant provisions of income-tax law.

Answer

Computation of total income and tax liability of M/s. Beta & Co., a partnership firm, as per the normal provisions of the Act for A.Y. 2020-21

Particulars		₹ (in lakhs)
Business income (before deduction under section 10AA)		
SEZ Unit		50.00
Add: Amount debited to SEZ Re-investment Reserve		20.00
		70.00
DTA Unit		40.00
		110.00
Less: Deduction u/s 10AA		
= ₹ 70 lakhs × ₹ 150 lakhs/₹ 210 lakhs = 50 × 50% (being the 12th year)	25.00	
Amount credited to SEZ Re-investment Reserve Account	20.00	
- whichever is less is deductible		**20.00**
Total Income		**90.00**
Tax on total income@30%		27.00
Add: Health and Education Cess@4%		1.08
Tax liability (as per normal provisions)		**28.08**

Computation of Adjusted total income and Alternate Minimum tax of M/s. Beta & Co., a partnership firm, as per the provisions of section 115JC for A.Y.2020-21

Particulars	₹ (in lakh)
Total income as per the normal provisions	90.00

Add: Deduction under section 10AA	20.00
Adjusted total income	110.00
Tax@18.5% of Adjusted Total Income	20.350
Add: Surcharge @12% as the adjusted total income is > ₹ 1 crore	2.442
	22.792
Add: Health and Education cess @4%	0.912
Alternate Minimum Tax as per section 115JC	**23.704**

Since the tax payable as per the normal provisions of the Act is more than the alternate minimum tax payable, the total income as per normal provisions shall be liable to tax and the tax payable for A.Y. 2020-21 shall be ₹ 28.08 lakhs.

CHAPTER - 13
Charitable Trusts, Political Parties and Electoral Trust

Section A – ICAI Study Material Questions

Question 1

An educational institution having annual receipts of ₹ 1.20 crore during the P.Y. 2019-20, has to make an application to the prescribed authority before 31.3.2020 for claiming tax exemption under section 10(23C). Discuss the correctness or otherwise of this statement.

Answer

This statement is **not** correct.

According to the first proviso to section 10(23C), an educational institution having aggregate annual receipts exceeding ₹ 1 crore, is required to make an application to the prescribed authority for grant of exemption under section 10(23C)(vi). Further, it is provided that such application can be made on or before 30th September of the relevant assessment year from which the exemption is sought.

Therefore, in the given case, the educational institution (having annual receipts of ₹ 1.20 crore during the P.Y. 2019-20) can make an application for grant of exemption in the prescribed form to the prescribed authority on or before 30th September, 2020, for claiming exemption under section 10(23C)(vi) for previous year 2019-20.

Question 2

An institution having its main object as "advancement of general public utility" received ₹ 30 lakhs in aggregate during the P.Y.2019-20 from an activity in the nature of trade. The total receipts of the institution, including donations, was ₹ 140 lakhs. It applied 85% of its total receipts from such activity during the same year for its main object i.e. advancement of general public utility.

(i) What would be the tax consequence of such receipt and application thereof by the institution?

(ii) Would your answer be different if the institution's total receipts had been ₹ 150 lakhs (instead of ₹ 140 lakhs) in aggregate during the P.Y.2019-20?

(iii) What would be your answer if the main object of the institution is "relief of the poor" and the institution receives ₹ 30 lakhs from a trading activity, when its total receipts are ₹ 140 lakhs and applies 85% of the said receipts for its main object?

Answer

(i) As the main object of the institution is "advancement of object of general public utility", the institution will lose its "charitable" status for the P.Y.2019-20, since it has received ₹ 30 lakhs from an activity in the nature of trade, which exceeds ₹ 28 lakhs, being 20% of the total receipts of the institution undertaking that activity for the previous year. The application of 85% of such receipt for its main object during the year would not help in retaining its "charitable" status for that year. The institution will lose its charitable status and consequently, the benefit of exemption of income for the P.Y.2019-20, irrespective of the fact that its approval is not withdrawn or its registration is not cancelled.

(ii) If the total receipts of the institution is ₹ 150 lakhs, and the institution receives ₹ 30 lakhs in aggregate from an activity in the nature of trade during the P.Y.2019-20, then it will not lose its "charitable" status since receipt of upto 20% of the total receipts of the institution in a

year from such activity is permissible. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13. Further, such activity should also be undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(iii) The restriction regarding carrying on of a trading activity for a cess, fee or other consideration will not apply if the main object of the institution is "relief of the poor". Therefore, receipt of ₹ 30 lakhs from a trading activity by such an institution will not affect its "charitable" status, even if it exceeds 20% of the total receipts of the institution. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13.

Question 3

(a) **"Save Wild Life"** an institution having its main object as 'preservation of wildlife', used the entire income derived from an activity in the nature of trade for its main object during the previous year ended on 31.03.2020. Would such utilization of its income be treated as utilisation for "charitable purpose"? Examine. Would your answer be different, if the main object of the institution is "advancement of object of general public utility"?

(b) A charitable trust derives its income from the business of providing mineral water to various companies situated in Software Technology Park in Hyderabad. A sum of ₹ 30 lacs has been derived as net income from such business activity, which has been applied for the object of general public utility. The total receipts of the trust during the P.Y. 2019-20 was ₹ 140 lakhs. Examine the taxability of application of the income, if the income so derived relates to the previous year 2019-20. Would your answer be different, if the trust runs a school in a backward district and applies the profits from the business for such school's activity?

Answer

(a) Section 2(15) defines "charitable purpose" to include relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, the "advancement of any other object of general public utility" shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity.

Therefore, preservation of wildlife is included in the definition of "charitable purpose" under section 2(15). Further, an institution having the preservation of wildlife as its main object would not be subject to the restrictions which are applicable to the "advancement of any other object of general public utility". Such institution would continue to retain its "charitable" status, even if it derives income from an activity in the nature of trade.

However, if an institution having its main object as "advancement of any other object of general public utility", derives income from an activity in the nature of trade during a financial year, it would lose its "charitable" status for that year, even if it applies such income for its main objects.

It may be noted that if the receipts from such activity does not exceed 20% of the total receipts in that year, then, the institution would not lose its "charitable" status, even if its main object is "advancement of any other object of general public utility", if such activity is

undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(b) In the first case, net income from the business of supplying mineral water to various companies i.e., ₹ 30 lakhs is not eligible for exemption under section 11, since the receipt from such activity exceeds 20% of total receipts (i.e., 20% of ₹ 140 lakhs) during the year. This is because "advancement of any object of general public utility" would not be a charitable purpose if it involves carrying on of any activity in the nature of trade, commerce or business, for example, supply of mineral water for a consideration, as in this case. It is immaterial that the net income from such business is applied for the object of general public utility.

On the other hand, where the trust runs a school in a backward district, this restriction is not applicable. The reason is that the restriction contained in section 2(15) is applicable only to the last limb of the definition of "charitable purpose" i.e. advancement of object of general public utility. It does not affect the other limbs of the definition viz. "relief of the poor", "education", "medical relief" etc.

Section 11(4) clarifies that "property held under trust" includes a business undertaking so held. As per section 11(4A), exemption can be availed in respect of profits and gains of business, if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business. Therefore, in the second case, the profit from the business shall be eligible for exemption under section 11, assuming that the said business is incidental to the attainment of the objects of the trust (i.e., education) and books of account for such business activity is maintained separately.

Question 4

A charitable institution registered under section 12AA of the Income-tax Act, 1961 filled in Form No.10 for seeking permission to accumulate unapplied income under section 11(2) of the Act for the objects of the institution and submitted it to the Assessing Officer along with the resolution for accumulation. The Assessing Officer found that the objects for which accumulation was sought were not particularised in as much as they covered the entire range of objects of the institution. Can the Assessing Officer deny the benefit of accumulation in such a case?

Answer

Section 11(2) permits a charitable trust or institution to accumulate its unspent income where 85% of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year. The institution or trust has to specify, by notice in writing given to the Assessing Officer, the purpose for which the income is being accumulated or set apart and the period for which such income is to be accumulated or set apart.

In the given case, the assessee institution sought the permission of the Assessing Officer to accumulate unapplied income for the objects of the institution. The institution had not stated any objects in particular for which the unspent income was sought to be accumulated or set apart. In Bharat Krishak Samaj vs. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del.), it was held that it is not necessary for a charitable trust to particularize each and every object for which accumulation is sought. It is enough if the assessee seeks permission for accumulation for the objects of the trust. Therefore, the Assessing Officer cannot deny the benefit of accumulation in such a case.

Question 5

MSO Foundation, a charitable institution set up on 1st April, 2019 and registered under section 12AA with effect from that date, is engaged in providing education in hotel management. The organisation acquires a building for using the same for holding classes and office activities. It has approached you for your opinion on its eligibility to claim the cost of the building and also depreciation thereon in the current year and the subsequent year. Advise the institution indicating the reasons.

Answer

(i) 15% of income from property held for charitable purposes is exempt from tax under section 11. The remaining 85% of such "income" would be exempt if it is "applied" for charitable purposes in India.

(ii) Application of the amount can be for revenue or capital purposes. As long as the expenditure is incurred out of income earned by the trust and for the purposes of carrying on the objects of the trust, it would be treated as application of income even if such expenditure is for capital purposes. Therefore, since the building is acquired by the organization for holding classes and office activities, which is for the purposes of carrying on the objects of the charitable institution i.e., for providing education in hotel management, the cost of the building would be treated as application of income.

However, section 11 provides that where the cost of building is claimed as application, no other deduction for depreciation or otherwise would be allowed as an application of income in respect of such asset for the same or any other previous year.

Question 6

Hundi (charitable box) superscribing "contributions in this hundi form part of corpus of trust fund" kept at Lord Venkateshwara Temple, Tirumala, was opened on 30.3.2020. Cash of ₹ 100 lakhs and valuable articles worth ₹ 250 lakhs were found to have been contributed by the devotees. Discuss the tax implications.

Answer

As per section 11(1)(d), income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of the recipient. In the given case, there is a specific declaration by the temple authorities that the contributions being put in the hundi (charity box) would form part of the corpus of the trust fund. Therefore, it is possible to take a view that those who put the contributions in the hundi give a tacit declaration that the contributions would form part of the corpus. Hence, a view can be taken that such contributions shall not be included in the total income of the recipient trust.

Further, it may be noted that the provision relating to taxability of anonymous donations under section 115BBC does not apply to voluntary contributions received by a trust or institution created or established wholly for religious purposes.

Question 7

Can a trust created for charitable purposes in April 2019, having filed application for registration as per section 12A on 11.4.2020, claim benefits of sections 11 and 12 from Assessment Year 2020-21?

Answer

In respect of applications filed on or after 1st June, 2007, the provisions of sections 11 and 12 shall apply from the assessment year relevant to the financial year in which the application is made i.e., the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year.

Therefore, since the trust has filed application for registration only on 11.4.2020, it cannot claim benefit of sections 11 and 12 from A.Y.2020-21. Assuming that the registration has been granted under section 12AA, the exemption would be available only from the A.Y. 2021-22, being the assessment year relevant to the previous year in which application is filed [i.e., P.Y. 2020-21].

However, where a trust has been granted registration under section 12AA in the P.Y. 2020-21, the benefit of sections 11 and 12 shall be available in respect of any income derived from property held under trust for assessment year 2020-21, being the assessment year preceding the assessment year in which application is filed i.e., A.Y.2021-22, if assessment proceedings in respect of that year is pending before the Assessing Officer as on the date of such registration.

It may be noted that exemption in respect of an earlier assessment year can be claimed only if the objects and activities of such trust or institution in the relevant earlier assessment year are the same as those on the basis of which such registration has been granted.

Question 8

Help All, a trust created on 1st January, 2020 for providing relief to the poor, applied for registration under section 12A on 1st March, 2020. On that date, its corpus fund comprised only of the initial contribution made by the trustees. The Commissioner denied registration solely on the ground that the trust had not commenced any charitable activity, due to which he could not satisfy himself about the genuineness of the trust. Is the ground for denial of registration by the Commissioner justified in this case? Discuss.

Answer

The Karnataka High Court, in DIT (Exemptions) v. Meenakshi Amma Endowment Trust (2013) 354 ITR 219, opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in a case where the registration is sought much later after formation of the trust.

The High Court further observed that the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. The assessee-trust had not also collected any donation for the activities of the trust, by the time its application came up for consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

The High Court observed that, with the money available with the trust, it cannot be expected to carry out activity of charity immediately. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, where application is made shortly after formation of the trust, the objects of the trust as mentioned in the trust deed have to be taken into consideration by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it. Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).

Applying the rationale of the above ruling, the Commissioner cannot deny registration solely on the ground that the trust had not commenced any charitable activity in this case, since the trust has applied for registration under section 12A within two months after its formation and the corpus fund comprised only of contribution made by the trustees. The Commissioner has to take into consideration the objects of the trust as mentioned in the trust deed to satisfy itself about the genuineness of the trust.

Question 9

Educare, a trust created with the objective of promoting primary education in rural areas, filed an application for registration under section 12A on 30th April, 2019. Since the application was not disposed of by the Commissioner on or before 31st October, 2019 as required under section 12AA(2), the trust contended that it was deemed to be registered as per the provisions of section 12AA(1). Examine the correctness of contention of the trust.

Answer

As per the provisions of section 12AA(2), every order granting or refusing registration under section 12AA(1)(b), **shall** be passed by the registering authority before the expiry of six months from the end of the month in which the application was received under section 12A(1)(a) or section 12A(1)(aa).

The Supreme Court, in CIT v. Society for Promotion of Education (2016) 382 ITR 6, held that once an application under section 12AA was made and the same was not responded to within six months, the trust would be deemed as registered with effect from the date following the expiry of the six month period.

Applying the rationale of the above Supreme Court ruling in this case, the trust would be deemed as registered with effect from 1.11.2019. The contention that the trust is deemed to be registered, since its application for registration has not been disposed of within six months is, therefore, correct.

Note: The benefit of exemption under section 11 and 12 would be available from the A.Y. 2020- 21, being the assessment year relevant to the financial year in which such application is made.

Question 10

A charitable trust, whose income can be exempt under section 11 of the Income-tax Act, 1961, was formed on 1st March, 2017. For the accounting year ended 31st March, 2020, it earned an income of ₹ 3,60,000. It filed with the Commissioner of Income-tax its application for registration on 31st August, 2019 explaining that for good and sufficient reasons, it was prevented from filing the application for so long.

Examine -

(i) by which date the application for registration should have been filed;

(ii) whether such an application could have been filed before the formation of the trust;

(iii) in the absence of an order of registration from the Commissioner, can the trust be deemed to be registered;

(iv) the steps to be taken by the trust to secure exemption from income-tax;

(v) whether a certificate of registration once granted can be cancelled and if so, the conditions there for.

Answer

(i) The requirement of filing an application for registration under section 12A within one year of creation of the trust has been removed. The application can be filed at any time now. Accordingly, the provisions of sections 11 and 12 would apply from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application was filed.

However, where registration has been granted to the trust under section 12AA and on the said date, assessment proceedings relating to earlier assessment years are pending, then, the benefit of sections 11 and 12 shall be available in respect of income derived from property held under trust in those years, provided the objects and activities of the trust remain unchanged.

(ii) No. The application for registration under section 12A cannot be filed before the formation of the trust.

(iii) As per section 12AA(2), every order granting or refusing registration should be passed before the expiry of 6 months from the end of the month in which the application was received under section 12A. The Supreme Court, in CIT v. Society for Promotion of Education (2016) 382 ITR 6, held that the trust would be deemed as registered if the application under section 12AA is not disposed of within the stipulated period of six months. Therefore, in this case, the trust would be deemed as registered with effect from 1st March, 2020. The benefit of exemption under section 11 and 12 would be available from A.Y. 2020-21, being the assessment year relevant to the financial year in which the application is made.

(iv) The following are the steps to be taken by the trust to secure exemption from income-tax:

(1) The trust should be registered with the Principal Commissioner or Commissioner of Income-tax under section 12AA.

(2) The accounts of the trust for the previous year must be audited by a Chartered Accountant if its total income without giving effect to the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to tax. The audit report in the prescribed form, duly signed and verified by the Chartered Accountant, should be furnished along with the return of income of the trust for the relevant assessment year.

(3) At least 85% of the income is required to be applied for the approved purposes.

(4) The unapplied income and the money accumulated or set apart should be invested or deposited in the specified forms or modes, after filing statement in Form 10 on or before the due date of filing return of income specified under section 139(1).

(v) Yes, the certificate of registration can be cancelled by the Commissioner. According to section 12AA, if the Commissioner is satisfied that the activities of the trust are not genuine or are not being carried out in accordance with the objects of the trust, he shall, after giving the trust a reasonable opportunity of being heard, pass an order in writing cancelling the registration of the trust.

Further, section 12AA(4) provides that where a trust or an institution has been granted registration, and subsequently it is noticed that its activities are being carried out in such a manner that,—

(i) its income does not enure for the benefit of general public;

(ii) it is for benefit of any particular religious community or caste;

(iii) any income or property of the trust is applied for benefit of specified persons like author of trust, trustees etc.; or

(iv) its funds are invested in prohibited modes,

then, the Commissioner may cancel the registration of such trust or institution. **The Commissioner may also cancel the registration of such trust or institution, if it has not complied with the requirement of any other law and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality.** However, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the above manner, the registration shall not be cancelled.

Question 11

The following trusts claim that anonymous donations received by them during the financial year 2019-20 are not liable to tax under section 115BBC:

(i) A charitable trust referred to in section 11 which applied the entire amount of anonymous donations for purposes of the trust during the relevant financial year.

(ii) A trust established wholly for religious purposes which applied 85% of the amount of anonymous donations for the purposes of the objects of the trust during the relevant financial year.

Examine the validity of the claim made by the trusts.

Answer

(i) Section 115BBC provides for levy of tax @ 30% on anonymous donation received by, inter alia, charitable trusts or institutions referred to in section 11 in the following manner:

(a) the amount of income-tax calculated @30% on the aggregate of anonymous donations received in excess of 5% of the total donations received by the assessee or one lakh rupees, whichever is higher; and

(b) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of the anonymous donations received in excess of 5% of the total donations received by assessee or ₹ 1 lakh, as the case may be.

Further, section 13(7) provides that the exemption provisions contained in sections 11 and 12 shall not be applicable in respect of any anonymous donation liable to tax under section 115BBC. As such, application of the anonymous donations received by the charitable trust for charitable purposes does not confer any exemption from tax. Therefore, the claim for non-taxability under section 115BBC of anonymous donations received by the charitable trust is not valid in law.

However, a view may be taken that anonymous donation upto higher of 5% of total donations or ₹ 1 lakh, which is taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 would apply.

(ii) Section 115BBC(2) provides that the provisions contained in section 115BBC(1) relating to the taxability of anonymous donations are not applicable to any trust or institution created or established wholly for religious purposes. As such, the trust established wholly for religious purposes is not liable to be taxed in respect of the anonymous donations received by it. Therefore, the claim made by the trust is valid in law. The application or non-application of such anonymous donation for the purposes of trust during the relevant financial year is not germane to the issue of taxability under section 115BBC.

Question 12

A trust, unless created for "charitable purpose", does not qualify to claim exemption under Chapter III of the Act. In this context, explain the meaning of "charitable purpose" and examine whether the following objects constitute part of it:

(i) Rural reconstruction and upliftment of the masses through Cottage Industry.

(ii) Welfare of industrial workers with a stipulation that the workers of settlor of trust have got preference over others.

Answer

Section 2(15) defines "charitable purpose" to include relief of the poor, education, medical relief, yoga, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, "advancement of any other object of general public utility" would not be a charitable purpose, if it involves carrying on of any activity in the nature of trade, commerce or business or, any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity or the retention of such income, by the concerned entity.

"Advancement of any other object of general public utility" would continue to be a "charitable purpose", if the total receipt from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed 20% of the total receipts of the trust in the previous year, and such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(i) The Supreme Court has, in Thiagarajar Charities vs. Addl. CIT (1997) 225 ITR 1010, observed that "cottage industry" is associated with the idea of a small, simple enterprise or industry in which employees work in their own houses or in a small place, gathered together for the purpose, using their own equipments and is usually found in rural areas or so carried on, by the poorer section of the society. In substance, the activity of rural reconstruction and upliftment of masses through cottage industry is to afford relief to the poor and consequently, it is for charitable purpose.

(ii) The welfare of industrial workers with a stipulation that the workers of settlor of trust have preference over others would also constitute "charitable purpose" within the meaning of section 2(15). The Patna High Court has, in CIT v. Tata Steel Charitable Trust (1993) 203 ITR 764, observed that exemption under section 11(1) can be availed only if the following conditions are satisfied –

(1) the trust is created for a charitable purpose; and

(2) no part of the income of such trust enures or has been used or applied directly or indirectly for the benefit of any person referred to in section 13(3).

The list of persons contained in section 13(3) does not include employees of the settlor of the trust. Section 13(3)(d), which includes any relative of the author, can have no application because "relative" means a person connected by birth or marriage with another person. A person having relationship pursuant to a contract like that of an employer and an employee cannot be said to be a relative. The High Court concluded that it was immaterial that any employee of the settler of the trust had acquired any benefit out of the income of the trust as an ordinary member of the community. Therefore, the application of part of the income of the trust for the benefit of the employees of the settler cannot disentitle the trust from claiming exemption under section 11.

Question 13

How do you deal with the following situation? Give reasons for your answer.

Ramji Charitable Trust has filed return of income for the Assessment Year 2020-21 within the stipulated time under section 139(1) and applied only 50% of its income for specified purposes. It intends to accumulate the balance 35% of income to be spent in future years. While completing the assessment, the Assessing Officer disallowed the accumulated income of 35% and taxed the same on the ground that the trust has not made any application under section 11(2) along with return of income. Discuss the validity of the action of the Assessing Officer in this case.

Answer

Section 11(2) provides that a charitable trust has to apply 85% of its income to charitable purposes and where 85% of its income is not applied for such purposes, the trust may accumulate or set apart either the whole or part of its income for future application for such purposes in India. The requirement of the Act is that the trust has to make an application/intimation in the prescribed form, for accumulation of income, specifying the purpose and the period (not exceeding 5 years). The application should be filed or furnished before the assessing authority on or before the due date specified under section 139(1). Further, the money so set apart or accumulated should be invested/deposited in any one or more of these modes or forms specified under section 11(5).

Thus, this requirement of filing application is mandatory and without those particulars, the assessing authority cannot entertain the claim of the assessee under section 11. In case the statement in Form 10 is not submitted on or before the due date of filing return of income under section 139(1), then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing of return of income under section 139(1). Therefore, the action of the Assessing Officer in this case is valid.

Question 14

An institution operating for promotion of education claiming exemption under section 11 since 1994 furnishes the following data for the assessment year 2020-21:

S. No.	Particulars	₹ in crores
(i)	Fees collected from students	14
(ii)	Construction of a new computer science laboratory	0.50
(iii)	Land acquired to be used as a cricket field for the students	2
(iv)	Amount earmarked and set apart for construction of an arts block within the next 4 years.	4

Compute the total income of the institution for the A.Y.2020-21.

Answer

Computation of total income of the institution for the A.Y. 2020-21

Particulars	₹ (in crores)
Fees received	14.00
Less : 15% (exempt even if not spent for the objects of the institution)	2.10
	11.90
Less : Accumulated for specified purpose **(See Note 2)**	4.00
Balance to be spent	7.90

Actual amount spent on construction of computer science lab **(See Note 1)**	0.50
Actual amount spent on purchase of land for cricket field **(See Note 1)**	2.00
Total Income	**5.40**

Notes:

(1) The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Land acquired and meant for use as cricket field for students is a capital expenditure incurred for promoting the objects of the institution and hence, eligible for deduction. Likewise, the amount spent on construction of computer science laboratory is also eligible for deduction.

(2) Section 11(2) provides that a trust/institution can accumulate or set apart its income for a specified purpose by furnishing statement in prescribed format to the concerned Assessing Officer. However, the period for which the funds can be accumulated cannot exceed 5 years. The amount so accumulated should be invested in the specified forms and modes. In this case, the institution has to furnish statement in Form 10 on or before the due date of filing return of income to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for which the income is being accumulated or set apart, which shall, in no case, exceed five years. Further, the institution has to invest ₹ 4 crore in the specified forms and modes.

Question 15

A public charitable trust registered under section 12AA, for the previous year ending 31.3.2020, derived gross income of ₹ 21 lakhs, which consists of the following:

	(₹ in Lacs)
(a) Income from properties held by trust (net)	10
(b) Income (net) from business (incidental to main objects)	4
(c) Voluntary contributions from public	7

The trust applied a sum of ₹ 11.60 lacs towards charitable purposes during the year which includes repayment of loan taken for construction of orphanage ₹ 3.60 lacs.

Determine the taxable income of the trust for the assessment year 2020-21..

Answer

Computation of taxable income of public charitable trust

	Particulars	**₹**
(i)	Income from property held under trust (net)	10,00,000
(ii)	Income (net) from business (incidental to main objects)	4,00,000
(iii)	Voluntary contributions from public	7,00,000
	Voluntary contribution made with a specific direction towards corpus are alone to be excluded under section 11(1)(d). In this case, there is no such direction and hence, included.	
		21,00,000
	Less: 15% of the income eligible for retention / accumulation without any conditions	3,15,000
		17,85,000

Less: Amount applied for the objects of the trust	
(i) Amount spent for charitable purposes (₹ 11,60,000 - ₹ 3,60,000)	8,00,000
(ii) Repayment of loan for construction of orphan home	3,60,000
Taxable Income	**6,25,000**

Question 16

A charitable trust registered under section 12AA of the Income-tax Act, 1961 has, out of its income of ₹ 3,90,000 for the year ending 31.3.2020 and sale proceeds of a capital asset, held by it for less than 24 months, amounting to ₹ 9,60,000, purchased a building during the year ending 31.3.2020 for ₹ 13,50,000. The capital asset was sold during the year ending 31.3.2020. The building is held only for charitable purposes. The trust claims that the purchase of the building amounts to application of its income for charitable purposes and that the capital gain arising on the sale of the capital asset is deemed to have been applied to charitable purposes. Is the claim made by the charitable trust valid in law?

Answer

Section 11(1)(a) stipulates that in order to avail exemption of income derived from property held under trust wholly for charitable or religious purposes, the trust is required to apply for charitable or religious purposes, 85% of its income from such property. In this case, the trust has earned income of ₹ 3,90,000 for the year ended 31.3.2020. It has also earned short term capital gain from sale of capital asset for ₹ 9,60,000. The trust had utilized the entire amount of ₹ 13,50,000 for the purchase of a building meant for charitable purposes.

The Supreme Court, in S.RM. M. CT. M. Tiruppani Trust v. CIT (1998) 230 ITR 636, ruled that the assessee-trust, which applied its income for charitable purposes by purchasing a building for use as a hospital, was entitled to exemption under section 11(1) in respect of such income.

The ratio of the decision squarely applies to the case of the charitable trust in question. Therefore, the charitable trust is justified in claiming that the purchase of the building amounted to application of its income for charitable purposes.

Under section 11(1A), where the whole of the sale proceeds of a capital asset held by a charitable trust is utilised by it for acquiring another capital asset, the capital gain arising therefrom is deemed to have been applied to charitable purposes and would be exempt. Section 11(1A) does not make any distinction between a long-term capital asset and a short-term capital asset. The claim of the charitable trust to the effect that the capital gain is deemed to have been applied to charitable purposes is tenable in law.

Question 17

Work out, from the following particulars, the amount of capital gain which shall be deemed to have been applied for charitable or religious purpose arising out of sale of a capital asset utilized for the purposes of trust to the extent of 60%:

Particulars	₹
Cost of transferred asset	2,40,000
Sale consideration	3,60,000
Cost of new asset purchased	3,00,000

Answer

In this case, since the asset which is transferred is utilized for the purposes of the trust only to the extent of 60%, only the proportionate amount (i.e. 60%) of the capital gain would be regarded as having been applied for charitable or religious purposes.

As per section 11(1A), where a capital asset held under trust is transferred, and only a part of the net consideration is utilized for acquiring a new capital asset, only so much of the capital gain as is equal to the amount, if any, by which the amount so utilized exceeds the cost of the transferred asset shall be considered to have been applied for the objects of the trust.

In this case, only a part of the net consideration of ₹ 3,60,000 is utilized for acquiring the new capital asset costing ₹ 3,00,000. The amount utilized in acquiring the new asset (i.e. ₹ 3,00,000) exceeds the cost of the transferred asset (i.e. ₹ 2,40,000) by ₹ 60,000.

Therefore, only 60% of (₹ 3,00,000 – ₹ 2,40,000) = 60% of ₹ 60,000 = ₹ 36,000 is deemed to be applied for the objects of the trust.

Question 18

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2020 in following case shall be subject to tax in the A.Y. 2020-21:

A political party, duly registered under section 29A of the Representation of the People Act, 1951, received rent of ₹ 1,25,000 per month of one of its building let out to a bank from 01.06.2019.

Answer

Rent received by the political party from the bank is an income chargeable under the head "Income from house property". However, according to the provisions of section 13A, income from, inter alia, house property shall not be included in total income of a political party registered under section 29A of the Representation of the People Act, 1951, provided the political party fulfils the conditions as specified therein including furnishing a return of income for the previous year in accordance with the provisions of section 139(4B) on or before the due date under section 139. Therefore, if the stipulated conditions are fulfilled by the political party, rent of ₹ 1,25,000 per month received by the registered political party from letting out of its building to a bank would not be included in its total income.

Question 19

The books of account maintained by a National Political Party registered with Election Commission for the year ended on 31.3.2020 discloses the following receipts:

		₹
(a)	Rent of property let out to a departmental store at Chennai	6,00,000
(b)	Interest on deposits other than banks	5,00,000
(c)	Contribution from 100 persons (who have secreted their names) of ₹ 21,000 each	21,00,000
(d)	Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each	2,50,000
(e)	Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)	21,00,000
(f)	Net profit of cafeteria run in the premises at Delhi	3,00,000

Compute the total income of the political party for the assessment year 2020-21, with reasons for inclusion or otherwise.

Answer

The total income of a political party registered with the Election Commission is to be computed as per section 13A under which the income derived from house property, income from other sources and income by way of voluntary contributions received from any person, on fulfilling of the conditions as mentioned thereunder, are exempt from tax. However, in this case, since cash contribution in excess of ₹ 2,000 is received from 1000 persons, the political party has violated the condition of receipt of donation through account payee cheque/draft or prescribed electronic modes. Further, the political party has also violated the condition of maintenance of records in case of donations exceeding ₹ 20,000 received otherwise than by way of electoral bonds. Hence, its total income has to be computed as under without providing for exemption available under section 13A:

Computation of total income of National Political Party

	Particulars	₹
(a)	The rent of the property of ₹ 6 lacs located at Chennai [assuming the same to be the Gross Annual Value] less 30% of Rs.6 lacs, being deduction u/s 24	4,20,000
(b)	Interest received on deposits	5,00,000
(c)	Contribution from 100 persons (who have secreted their names) of ₹ 21,000 each	21,00,000
(d)	Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each	2,50,000
(e)	Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)	21,00,000
(f)	Net profit of cafeteria at Delhi	3,00,000
Total Income		**56,70,000**

Note – Alternatively, the political party can contend that only ₹ 45 lakh is taxable on account of non-maintenance of records and receipt of cash donations, in which the case the total income would be computed as under:

Computation of total income of National Political Party

	Particulars	₹
(a)	Rent of the property of ₹ 6 lacs located at Chennai	Exempt
(b)	Interest received on deposits	Exempt
(c)	Contribution from 100 persons (who have secreted their names) of ₹ 21,000 each	21,00,000
(d)	Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each	Exempt
(e)	Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)	21,00,000
(f)	Net profit of cafeteria at Delhi	3,00,000
	Total Income	**45,00,000**

Note: It is presumed that the conditions regarding maintenance of books of account, audit, submission of report under section 29C of the Representation of the People Act, 1951 and filing of return of income under section 139(4B) are fulfilled by the political party, and hence it is eligible for exemption of income under section 13A.

Question 20

An electoral trust approved by the CBDT is not liable to income-tax in respect of voluntary contribution received and other income - Examine the correctness of the statement.

Answer

Section 13B provides exemption in respect of voluntary contribution received by an electoral trust approved by the CBDT in accordance with the scheme to be made by the Central Government.

Voluntary contribution received by an electoral trust would be treated as its income under section 2(24), but shall be exempt under section 13B if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with surplus brought forward from any earlier years. Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules framed by the Central Government.

It may be noted that the exemption under section 13B will be available only in respect of voluntary contribution received by an electoral trust. The exemption cannot be claimed in respect of any other income of the electoral trust.

Therefore, the given statement is not correct.

Section B – Additional Questions

Question 21

Mathi Charitable Trust registered under section 12AA, following cash system of accounting, furnishes you the following information:

(i) Gross receipts from hospital by name "Full Cure" ₹ 400 lakhs.

(ii) Gross receipts from college by name "India Arts College ₹ 180 lakhs (offering recognized degree courses).

(iii) Corpus donations by way of cheque ₹ 30 lakhs and by way of cash ₹ 5 lakhs.

(iv) Anonymous donations by cash ₹ 10 lakhs.

(v) Administrative expenses for hospital ₹ 220 lakhs and for college ₹ 100 lakhs.

(vi) Fees not realized from patients ₹ 20,60,000 and from students of the college ₹ 6,50,000 as on 31st March, 2020.

(vii) Depreciation on assets of the trust ₹ 18,00,000. The entire cost of assets ₹ 300 lakhs claimed as application in the earlier years.

(viii) Acquired a building for ₹ 120 lakhs on 01.06.2019 for expansion of hospital (cost of land included therein ₹ 100 lakhs). Stamp duty value of the land and building on the date of registration of sale deed ₹ 140 lakhs.

(ix) The trust gave donation of ₹ 25 lakhs to Gandhiji Free Trust having objects of charitable nature registered under section 12AA but not similar to the objects of the donor trust.

You are required to compute the total income of the trust and its income-tax liability in such a manner that it can avail the optimal benefit within the four corners of the Income- Tax Act, 1961.
Note: The trust does not want to seek accumulation of income by virtue of section 11(2) of the Act.

Answer

Computation of total income of Mathi Charitable Trust for the A.Y.2020 -21

Particulars	₹	₹
Gross receipts from Full Cure Hospital		4,00,00,000
Gross receipts from India Arts College		1,80,00,000
		5,80,00,000
Add: Anonymous donations [to the extent not chargeable to tax@30% under section 115BBC(1)(i)] **[See Note 1]**		2,25,000
		5,82,25,000
Less: 15% of income eligible for being set apart without any condition		87,33,750
		4,94,91,250
Less: Amount applied for charitable purposes **[See Note 2]**		
- **On revenue account** – Administrative expenses: For Hospital	2,20,00,000	
For College	1,00,00,000	
- **On capital account** – Land & Building	1,20,00,000	
[Section 56(2)(x) is not attracted in respect of value of property received by a trust or institution registered u/s 12AA]		

- Donation to Gandhiji Free Trust registered u/s 12AA – allowable since the same is out of current year income of the trust, even though the objects of the trust are different. Only corpus donations are not permissible to other trusts registered u/s 12AA	25,00,000	4,65,00,000
Total income [other than anonymous donation taxable@30% under section 115BBC(1)(i)]		**29,91,250**
Add: Anonymous donation taxable @30% u/s 115BBC(1)(i) **[See Note 1]**		7,75,000
Total Income of the trust (including anonymous donation taxable@30%)		**37,66,250**

Computation of tax liability of the trust for the A.Y. 2020-21

Particulars	₹	₹
Tax on total income of ₹ 29,91,250 [Excluding anonymous donations]		
Upto ₹ 2,50,000	Nil	
₹ 2,50,000 – ₹ 5,00,000 [₹2,50,000 x 5%]	12,500	
₹ 5,00,000 – ₹10,00,000 [₹5,00,000 x 20%]	1,00,000	
> ₹ 10,00,000 [₹19,91,250 x 30%]	5,97,375	
	7,09,875	
Tax on anonymous donations taxable@30% [₹7,75,000 x 30%]	2,32,500	9,42,375
Add: Education cess @4%		37,695
Total tax liability		**9,80,070**
Total tax liability (rounded off)		**9,80,070**

Note – In the above solution, the provisions of section 13(7) have been interpreted in a manner that it excludes only anonymous donations subject to tax@30% under section 115BBC(1)(i). All taxable income of the trust [excluding anonymous donations taxable@30% u/s 115BBC(1)(i)] falls under section 115BBC(1)(ii), and are subject to tax at normal rates and eligible for benefit of unconditional accumulation u/s 11(1). Anonymous donation of ₹ 2,25,000 taxable at normal rates also falls u/s 115BBC(1)(ii) and hence, like other taxable income of the trust falling within the scope of this clause, the same would also be eligible for the benefit of unconditional accumulation under section 11(1). The above solution has been worked out on the basis of this interpretation of section 13(7), which in fact, appears to be the real intent of this section. Accordingly, in the above solution, the benefit of unconditional accumulation upto 15% under section 11(1) has been given in respect of anonymous donation of ₹ 2,25,000 subject to tax at normal rates.

Question 22

Medicare Trust running hospitals is registered under section 12AA. From the following particulars relevant for the previous year ended 31st March, 2020, you are required to compute taxable income and tax liability of the trust for A.Y.2020-21.

(i) Income from running of hospitals ₹ 108 lakhs.

(ii) Income from medical college (gross receipts ₹ 95 lakhs) ₹ 24 lakhs

(iii) Donation received (including anonymous donation ₹ 3 lakhs) ₹ 8 lakhs.

(iv) Amount applied for the purposes of hospital ₹ 93.50 lakhs.

(v) The trust had accumulated ₹ 20 lakhs under section 11(2) in the financial year 2013-14 for a period of five years for extension of one of its hospitals. The trust has spent ₹ 15 lakhs for the said purpose till 31st March, 2019. No amount was spent in the year 2019-20.

Answer

Computation of taxable income of Medicare Trust for A.Y. 2020-21

Particulars	₹	
Income from running of hospitals	1,08,00,000	
Income from medical college [exempt u/s 10(23C)(iiiad)]	Nil	
Donation other than anonymous donation of ₹ 2,00,000 taxable @30% (₹ 3,00,000, being reduced by 5% of ₹ 8,00,000 or ₹ 1,00,000, whichever is higher) [₹8,00,000 – ₹2,00,000]	6,00,000	1,14,00,000
Less: 15% of income of ₹ 114 lakhs accumulated or set apart under section 11(1)(a)		17,10,000
		96,90,000
Less: Amount applied for the purposes of hospital		93,50,000
		3,40,000
Add: Amount accumulated for extension of a hospital but not spent deemed to be income under section 11(3) (₹ 20 lakhs – ₹ 15 lakhs) **(See Note 1 below)**		5,00,000
		8,40,000
Add: Anonymous donation taxable @30% under section 115BBC **(See Note 2 below)**		2,00,000
Total Income		**10,40,000**
Tax on total income		
Tax on anonymous donation of ₹ 2 lacs at 30% **(See Note 2 below)**		60,000
Tax on other income of ₹ 8,40,000 at normal rates		
Upto ₹ 2,50,000	Nil	
Over ₹ 2,50,000 up to ₹ 5,00,000 @ 5%	12,500	
Over ₹5,00,000 upto ₹8,40,000@20%	68,000	80,500
		1,40,500
Education cess @4%		5,620
Tax payable		**1,46,120**
Tax payable (rounded off)		**1,46,120**

Notes:

(1) Section 11(3) provides that if the income accumulated for certain purpose is not utilized for the said purpose within the period (not exceeding 5 years) for which it was accumulated, or in the year immediately following the expiry thereof, then the unutilised amount is deemed to be the income of the charitable institution for the previous year immediately following the expiry of the period of accumulation. In the instant case, Medicare Trust accumulated ₹ 20,00,000 in the previous year 2013-14 for extension of one of its hospitals for a period of 5 years. Period of accumulation thus expired on 31.3.2019. The assessee has spent ₹ 15,00,000 out of accumulated sum of ₹ 20,00,000 up to 31.3.2019. Therefore, the unutilised amount of ₹ 5,00,000, which is not utilized in the P.Y.2019-20 also, is deemed to be income of the previous year 2019-20 (A.Y. 2020-21).

(2) Only the anonymous donations in excess of the exemption limit specified below would be subject to tax@30% under section 115BBC.

The exemption limit is the higher of the following –

(1) 5% of the total donations received by the assessee [i.e., ₹ 40,000 (5% x ₹ 8 lakhs)]; or

(2) ₹1 lakh.

Therefore, in this case the exemption would be ₹ 1 lakh. The total tax payable by such institution would be –

(1) tax@30% on the anonymous donations exceeding the exemption limit as calculated above [i.e., tax@30% on ₹ 2,00,000, being ₹ 3,00,000 – ₹ 1,00,000)]; and

(2) tax on the balance income i.e., total income as reduced by ₹ 2,00,000, being the aggregate amount of anonymous donations in excess of ₹ 1 lakh.

Question 23

Mani foundations, a charitable trust registered under section 12AA of the Income-tax Act, 1961, run schools for primary and secondary education. The following particulars pertaining to the previous year 2019-20 are furnished to you by the trust:

		₹ (in lakhs)
(i)	Gross receipts from students towards tuition fees, development fees, laboratory fees etc.	200
(ii)	Voluntary contributions received from public (including anonymous donation ₹ 5 lakhs)	25
(iii)	Government grants	8
(iv)	Donation given towards corpus to a trust registered under section 10(23C)	2
(v)	Amount applied for the purpose of schools	90
(vi)	Included in (v) above, a sum of 5 lakhs, being the amountapplied for the benefit of the founder of the trust.	
(vii)	The trust set apart ₹ 55 lakhs for acquiring a building to expand its schools. But the amount was paid in December 2020 when the sale deed was registered in its name	
(viii)	Excess of expenditure over income in the previous year 2018-19	25

Compute the total income of the trust for the assessment year 2020-21 in order to avail maximum benefits within the four corners of law.

Answer

Computation of total income of Mani Foundations for the A.Y.2020-21

Particulars	₹	₹
Gross receipts from students towards tuition fees, development fees etc.		2,00,00,000
Government Grants (taxable, since only grant for the purpose of corpus of a trust established by the Central or State Government is excluded from the definition of income)		8,00,000
[**Note -** Government Grants would be exempted based on the assumption that Mani Foundations is set up by the Central or State Government and the grant is towards the corpus of the trust]		
Voluntary contributions (other than anonymous donations) [₹ 25 lakh – ₹5 lakh]		20,00,000
		2,28,00,000

Add: Anonymous donations [to the extent not chargeable to tax@30% under section 115BBC(1)(i)] **[See Note below]**		1,25,000
		2,29,25,000
Less: 15% of income eligible for being set apart without any condition		34,38,750
		1,94,86,250
Less: Amount applied for charitable purposes		
- Amount applied for the purpose of schools (excluding amount applied for the benefit of the founder) = ₹90 lakh – ₹5 lakh	85,00,000	
- Amount set apart for acquiring a building to expand its schools	55,00,000	
[The word "applied" used in section 11 means that the income is actually applied for the charitable purposes of the trust. The word "applied" does not necessarily imply "spent". Even if a certain amount is irretrievably earmarked and allocated for charitable purposes, the said amount can be deemed to have been applied for charitable purposes.]		
- Corpus donations to a trust registered under section 10(23C) [Deduction is not permissible only in respect of corpus donations to a trust registered u/s 12AA]	2,00,000	
- Excess of expenditure over income in the P.Y.2018-19	25,00,000	1,67,00,000
		27,86,250
Add: Amount applied for the benefit of the founder of the trust chargeable to tax under section 12(2) read with section 13(6)		5,00,000
Anonymous donation taxable @30% under section 115BBC(1)(i) **[See Note below]**		3,75,000
Total Income of the trust (including anonymous donation taxable@30%)		**36,61,250**

Note - As per section 115BBC(1)(i), the anonymous donations in excess of the higher of the following would be subject to tax@30%; - ₹ 1.25 lakh, being 5% of the total donations received i.e., 5% of ₹ 25 lakh; or ₹ 1 lakh

Therefore, anonymous donations of ₹ 3.75 lakh (₹ 5 lakh – ₹ 1.25 lakh) would be subject to tax@30% under section 115BBC(1)(i).

Such anonymous donations which are subject to tax@30% are not eligible for the benefit of exclusion from total income under sections 11 and 12.

[Alternate Answer] – As per plain reading of section 13(7), it is possible to take a view that the entire anonymous donations may not be eligible for benefit of exclusion from total income u/s 11 and 12. If this view is taken, then ₹ 1.25 lakhs should not be added to ₹ 228 lakhs. Accordingly, ₹ 34.20 lakhs, being 15% of ₹ 228 lakhs would be the income eligible for accumulation without any condition. The total income of trust (including anonymous donations) would be ₹ 36.80 lakhs.

Question 24

Edu All Charitable Trust registered under section 12AA, following cash system of accounting, furnishes you the following information for P.Y. 2019-20:

(i) Gross receipts from hospital ₹ 200 lakhs.
(ii) Gross receipts from medical college ₹ 95 lakhs (offering recognized degree courses).
(iii) Corpus donations by way of cheque ₹ 42 lakhs and by way of cash ₹ 6 lakhs.
(iv) Anonymous donations by cash ₹ 12 lakhs.
(v) Administrative expenses for hospital ₹ 75 lakhs.
(vi) Fees not realized from patients ₹ 18,00,000 as on 31st March, 2020.
(vii) Depreciation on assets of the trust ₹ 37,50,000. The entire cost of assets ₹ 250 lakhs claimed as application in the earlier years.
(viii) Acquired a building for ₹ 80 lakhs on 01.06.2019 for expansion of hospital (cost of land included therein ₹ 50 lakhs). Stamp duty value of the land and building on the date of registration of sale deed ₹ 210 lakhs.
(ix) The trust gave corpus donation of ₹ 19 lakhs to Help Aid Trust having objects of charitable nature registered under section 12AA but not similar to the objects of the donor trust.

You are required to compute the total income of the trust and its income-tax liability in such a manner that it can avail the optimal benefit within the four corners of the Income- Tax Act, 1961.

Note: Trust does not want to seek accumulation of income by virtue of section 11(2) of the Act.

Answer

Computation of total income of Edu All Charitable Trust for the A.Y.2020-21

Particulars	₹	₹
Gross receipts from Hospital		2,00,00,000
Gross receipts from Medical College [exempt, since less than ₹1 crore]		-
		2,00,00,000
Add: Anonymous donations [to the extent not chargeable to tax@30% under section 115BBC(1)(i)] **[See Note 1 & 2]**		3,00,000
		2,03,00,000
Less: 15% of income eligible for being set apart without any condition		30,45,000
		1,72,55,000
Less: Amount applied for charitable purposes		
- **On revenue account** – Administrative expenses	75,00,000	
- **On capital account** – Land & Building [Section 56(2)(x) is not attracted in respect of value of property received by a trust or institution registered u/s 12AA]	80,00,000	
- Corpus donation to Help Aid Trust registered u/s 12AA – not allowable even if it is out of current year income of the trust	-	1,55,00,000
Total income [other than anonymous donation taxable@30% under section 115BBC(1)(i)]		**17,55,000**
Add: Anonymous donation taxable @30% u/s 115BBC(1)(i) **[See Note 1]**		9,00,000
Total Income of the trust (including anonymous donation taxable@30%)		**26,55,000**

Computation of tax liability of the trust for the A.Y. 2020-21

Particulars	₹	₹
Tax on total income of ₹ 17,55,000 [Excluding anonymous donations]		
Upto ₹ 2,50,000	Nil	

₹ 2,50,001 – ₹ 5,00,000 [₹2,50,000 x 5%]	12,500	
₹ 5,00,001 – ₹ 10,00,000 [₹5,00,000 x 20%]	1,00,000	
> ₹ 10,00,000 [₹7,55,000 x 30%]	2,26,500	
	3,39,000	
Tax on anonymous donations taxable@30% [₹9,00,000 x 30%]	2,70,000	6,09,000
Add: Health and education cess @4%		24,360
Total tax liability		**6,33,360**

Notes:

(1) Anonymous donations taxable @30%	₹	₹
Anonymous Donations received (lakhs)		12.00
5% of total donations received, i.e. 5% of 60 lakhs	3.00	
Monetary limit	1.00	
Higher of the above		3.00
Anonymous donations taxable@30%		9.00

(2) The provisions of section 13(7) have been interpreted in a manner that it excludes only anonymous donations subject to tax@30% under section 115BBC(1)(i). All taxable income of the trust [excluding anonymous donations taxable@30% u/s 115BBC(1)(i)] falls under section 115BBC(1)(ii), and are subject to tax at normal rates and eligible for benefit of unconditional accumulation u/s 11(1). Anonymous donation of ₹ 3,00,000 taxable at normal rates also falls under section 115BBC(1)(ii) and hence, like other taxable income of the trust falling within the scope of this clause, the same would also be eligible for the benefit of unconditional accumulation under section 11(1). The above solution has been worked out on the basis of this interpretation of section 13(7). Accordingly, in the above solution, the benefit of unconditional accumulation upto 15% under section 11(1) has been given in respect of anonymous donation of ₹ 3,00,000 subject to tax at normal rates.

However, an alternative view is also possible on the basis of the plain reading of section 13(7), as per which anonymous donation referred to in section 115BBC has to be excluded from the purview of exemption under sections 11 and 12. As per this view, even the anonymous donations of ₹ 3,00,000 subject to tax at normal rates would not be eligible for unconditional accumulation of upto 15%.

(3) Corpus donations, whether received by way of cheque or cash, are not includible in the total income of the trust by virtue of section 11(1)(d).

(4) Since corpus donations and anonymous donations are indicated separately and the question does not mention that the same are included in gross receipts, the solution has been worked out on the assumption that corpus donations and anonymous donations are not included in the figure of gross receipts of ₹ 200 lakhs from hospital.

(5) Since the trust follows cash system of accounting, fees not realized from patients would not form part of gross receipts. Therefore, there is no need of applying the provisions of Explanation 1 to section 11(1) to exclude such income.

(6) Where the cost of assets is claimed as application, no deduction for depreciation on such assets would be allowed in determining income for the purposes of application. Therefore, since cost of assets of the trust has been claimed as application of income, no depreciation would be allowed on these assets while determining income for the purposes of application.

Question 25

Supporting the Girl Child, a charitable trust, is registered under section 12AA of the Act. On 1.4.2019, it got merged with M/s. Ananya P Ltd., which is a company engaged in manufacturing of stationery items. All the assets and liabilities of the erstwhile trust became the assets and

liabilities of M/s. Ananya P Ltd who is not entitled for registration under section 12AA of the Act. The trust appointed a registered valuer for the valuation of its assets and liabilities. From the following particulars (including the valuation report), calculate the tax liability in the hands of the trust arising as a result of such merger:

(i) Stamp duty value of land held ₹ 15 lakhs. However; if this land is sold in the open market, it would ordinarily fetch ₹ 17 lakhs. The book value of the land is ₹ 20 lakhs.

(ii) 75,000 equity shares in Idom Ltd. traded in Bombay Stock Exchange. The lowest price per share on 1.4.2019 was ₹ 75 and the highest price on that day was ₹ 85. The book value was ₹ 67 lakhs.

(iii) 55,000 preference shares held in Niharika Ltd. The shares will fetch ₹ 44 lakhs, if they are sold in the open market on 1.4.2019. Book value was ₹ 25 Lakhs.

(iv) Corpus fund as on 1.4.2019 ₹ 15 Lakhs.

(v) Outside liabilities ₹ 90 lakhs

(vi) Provision for taxation ₹ 5 lakhs.

(vii) Liabilities in respect of payment of various utility bills f 6 lakhs.

Note: Give reasons for treatment of each item.

Answer

As per section 115TD, the accreted income of "Supporting the Girl Child", a charitable trust, registered under section 12AA which is merged with M/s Ananya P Ltd., an entity not entitled for registration under section 12AA, would be chargeable to tax at maximum marginal rate @ 34.944% [30% plus surcharge @12% plus cess@4%].

Computation of accreted income and tax liability in the hands of the trust arising as a result of merger with Ananya Pvt. Ltd. for A.Y. 2020-21

Particulars	Amount (₹)
Aggregate FMV of total assets as on 1.4.18, being the specified date (date of merger) **[See Working Note 1]**	1,21,00,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**	96,00,000
Accreted Income	**25,00,000**
Tax Liability @ 34.944% of ₹25,00,000	**8,73,600**
Working Notes:	
Aggregate fair market value of total assets on the date of merger (WN 1)	
Land, being an immovable property	**17,00,000**
[The fair market value of land would be higher of ₹ 17 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and ₹ 15 lakhs, being stamp duty value as on the specified date]	
Quoted equity shares in Idom Ltd. [75,000 x ₹ 80 pe share]	**60,00,000**
[₹ 80 per share, being the average of the lowest (₹ 75) and highest price (₹ 85) of such shares on the date of merger]	
55,000 preference shares of Niharika Ltd.	
[The fair market value which it would fetch if sold in the open market on the date of merger i.e. FMV on 1.4.2019]	**44,00,000**
	1,21,00,000
Total liability (WN 2)	
Outside liabilities	90,00,000

Corpus Fund of ₹ 15 lakhs [not includible]	-
Provision for taxation ₹ 5 lakhs [not includible]	-
Liabilities in respect of payment of various utility bills [since this liability is an ascertained liability]	6,00,000
	96,00,000

Question 26

M/s Mahan Charitable Trust is running an Educational Institution with hostel facility for the orphan children. It is registered under section 12AA.

The details of income and expenditure of the Trust are as given below:

(a) Voluntary contributions received during the year ₹ 150 lakhs.
This includes:

(i) Corpus donation ₹ 20 lakhs
(ii) Donation of ₹ 20 lakhs from Mr. Michael, a foreign donor, which was received on 31-3-2020.

(b) Salary paid to teachers and administrative staff ₹ 40 lakhs.

(c) Other general expenses ₹ 10 lakhs include payment to grocery stores of ₹ 30,000 by crossed cheque.

(d) A land belonging to the Trust in a nearby village which was purchased in the year 2014-15 for ₹ 5 lakhs was sold for ₹ 10.50 lakhs and another land adjacent to the Trust premises was purchased for ₹ 12 lakhs to be used as playground for the children.

(e) Five laptops costing ₹ 50,000 each were purchased during the year for teaching purposes.

(f) The Trust had accumulated ₹ 30 lakhs under section 11(2) in the financial year 2015-16 for constructing a school building. Amount spent for the said purpose till 31-3-2020 was ₹ 27 lakhs. The project is completed with a saving in project cost.

(g) Two additional rooms measuring 1500 sq. ft each was constructed in the existing hostel for the children. Cost of construction is ₹ 1200 per sq. ft.

(h) It made a corpus donation of ₹ 20 lakhs to a charitable trust registered u/s 12AA having similar objects.

Compute taxable income of Mahan Charitable Trust for the assessment year 2020-21. Support your answer with necessary working notes.

Answer

Computation of total income of M/s. Mahan Charitable Trust for the A.Y.2020-21

Particulars	₹	₹
Voluntary contributions received during the year		1,50,00,000
Less: Corpus Donation		20,00,000
		1,30,00,000
Income from property held under trust [Capital Gains from sale of land (₹ 10.50 lakhs – ₹5 lakhs)]		5,50,000
		1,35,50,000
Less: 15% of income eligible for being set apart without any condition		20,32,500
		1,15,17,500
Less: Amount applied for charitable purposes		

Salary paid to teachers and administrative staff	40,00,000	
General expenses [₹ 10,00,000 – ₹ 30,000, payment by crossed cheque disallowed due to application of section 40A(3)]	9,70,000	
Capital gains re-invested in purchase of land for the purpose of the trust deemed to be applied for charitable purposes [₹ 10.50 lakhs – ₹ 5 lakhs]	5,50,000	
Excess of purchase price of new land over sale consideration of old land treated as application of income, since the new land is used for the purpose of the trust [₹12 lakhs – ₹10.50 lakhs]	1,50,000	
- Cost of laptops purchased for teaching purposes [₹50,000 x 5]	2,50,000	
- Cost of construction of hostel rooms [2 x ₹1200 x 1500 sq. ft]	36,00,000	
- Corpus donations of ₹ 20 lakhs to a trust registered u/s 12AA not permissible as deduction	Nil	
		95,20,000
		19,97,500
Amount accumulated for constructing a school building (₹ 30 lakhs) less amount actually spent (₹ 27 lakhs) taxable in the P.Y.2020-21 (A.Y.2021-22), being the year immediately succeeding the P.Y.2019-20 (A.Y.2020-21), the year in which project is completed		Nil
Total income [See Note below]		**19,97,500**

Note – If the trust exercises the option to apply the donations received (to the extent of ₹ 17.475 lakhs, being taxable portion of income of the trust i.e., ₹ 19,97,500 – ₹ 2,50,000, the basic exemption limit) from Mr. Michael on 31.3.2020 on or before the due date of filing of return u/s 139(1) in the prescribed form, the income would be deemed to have been applied for charitable purposes in the A.Y.2020-21. However, ₹ 17.475 lakhs should be applied before the end of the previous year 2020-21.

Question 27

The registration granted under section 12AA of the Income-tax Act, 1961 on 1-4-2010 to M/s S Charitable Trust, was cancelled on 31-1-2020 on a finding that the Trust was merged, with another entity neither having similar objects nor registered under section 12AA. An appeal was preferred against the order of cancellation, which was dismissed by the Appellate authorities. The order confirming the cancellation was received on 31 -3- 2020.

The Balance Sheet of M/s S Charitable Trust as on 31.1.2020, and its other information is given hereunder: (All amounts are in lakhs of Rupees)

Particulars	₹
Liabilities	
Capital fund	800.00
Sundry creditors	335.00
Total	**1135.00**
Assets	
Land (existing since 1-4-2009)	100.00
Land and buildings purchased in the year 2016	800.00

2000 equity shares of ₹ 1000 each in M/s X Ltd. shares are listed in Bombay Stock Exchange (at face value)	20.00
Balance in current account of a nationalized bank	10.00
Balanced in fixed deposits with scheduled banks	200.00
Cash in hand	3.50
Tax Deducted at Source	1.50
Total	**1135.00**

Additional Information:

(1) Stamp duty value of the land (existing since 2009) as on 31-1-2020 was ₹ 120.00 lakhs but if sold in the open market, the property would fetch ₹ 250 lakhs as per a registered valuer's certificate.

(2) Land and building (purchased in 2016), if sold in the open market will fetch ₹ 1000 lakhs as per a registered valuer's certificate. Stamp duty value as on 31 -1-2020 was ₹ 1050 lakhs.

(3) The highest and lowest value per share of M/s X Ltd. traded on 31-1-2020 was ₹ 1098 and ₹ 1051 respectively.

(4) Included in Sundry Creditors is ₹ 30 lakhs provided on estimated basis to contractors for which no bills are received.

Based on the above information, calculate the exit tax payable by the Charitable Trust and state the latest day on which the said tax has to be paid. Give working notes wherever necessary.

Answer

As per section 115TD, the accreted income of "M/s S Charitable Trust", registered u/s 12AA would be chargeable to tax at maximum marginal rate @ 34.944% [30% plus surcharge @12% plus cess@4%] on 31.1.2020 for the reason of cancellation of registration granted on 31.01.2020.

Computation of exit tax payable by M/s S Charitable Trust	
Particulars	**Amount (₹)**
Aggregate FMV of total assets as on 31.1.2019, being the specified date (date of order of cancellation of the registration) **[See Working Note 1]**	15,34,99,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**	3,05,00,000
Accreted Income	**12,29,99,000**
Tax Liability @ 34.944% of ₹ 12,29,99,000	**4,29,80,771**
Tax Liability (rounded off)	**4,29,80,770**
Working Note 1:	
Aggregate fair market value of total assets on the date of cancellation of the registration	
Valuation of Land, being an immovable property, existing since 2009	2,50,00,000
[The fair market value of land would be higher of ₹ 250 lakhs i.e., price that the land would ordinarily fetch if sold in the open market as per registered valuer's certificate and ₹120 lakhs, being stamp duty value as on the specified date i.e., 31.1.2020]	
Value of land purchased on 1.4.2009 is includible in the aggregate fair market value, since the exemption provisions under section 11 and 12 would apply from P.Y.2009-10, being the previous year in which application for registration of trust is made. Since the question states that registration was granted on 1.4.2010, it is logical to assume that the application was made in the P.Y.2009-10, and hence, benefit of exemption u/s 11 and 12 would be available from P.Y.2009-10, being the year in which the above land was purchased]	

Valuation of Land and building, being an immovable property, purchased in 2016 [The fair market value of land and building would be higher of₹1,000 lakhs i.e., price that the land and building would ordinarily fetch if sold in the open market as per registered valuer's certificate and ₹ 1,050 lakhs, being stamp duty value as on the specified date i.e., 31.1.2020]	10,50,00,000
Valuation of Quoted equity shares in M/s X Ltd. [2,000 x ₹ 1,074.50 per share] [The fair market value of quoted shares would be ₹ 1,074.50 per share, being the average of the lowest (₹ 1,051) and highest price (₹ 1,098) of such shares on the specified date i.e., 31.1.2020]	21,49,000
Balance in current account of a nationalized bank	10,00,000
Balance in fixed deposits with scheduled banks	2,00,00,000
Cash in hand	3,50,000
	15,34,99,000
Working Note 2 - Total liability	
Book value of liabilities in the balance sheet on specified date	11,35,00,000
- **Less:** Capital fund	8,00,00,000
- **Less:** Contingent liability on estimated basis to contractor for which no bills are received	30,00,000
Total liability of M/s S Charitable Trust	**3,05,00,000**
The latest day on which such tax has to be paid is 14th April, 2020, being 14 days from 31.3.3020, the date on which the order confirming the cancellation is received.	

Question 28

GVB Charitable Trust engaged in the activities of running a charitable hospital and medical college since 8 years, has been merged with a Corporate hospital on 31st March, 2020. The said Corporate Hospital is not eligible for registration under section 12AA of the Act. The position of assets and liabilities of the Charitable trust as on the date of merger are furnished as under:

Properties and Assets :		**₹**
(a)	Shares and securities held by Trust acquired out of agricultural income exempt u/s 10(1) of the Act:	25 lakhs
	Book value of Quoted shares and securities:	35 lakhs
	Market value (Average of lowest and highest price of such shares as on date of merger quoted on recognised stock exchange)	40 lakhs
(b)	Book value of Land and Buildings held by Trust:	60 lakhs
	Value of Immovable Properties (Land & Buildings) as per valuation report from Registered Valuer:	40 lakhs
	Stamp Duty value:	38 lakhs
(c)	The Trust was created on 1st January, 2014 and obtained registration under section 12AA on 31st March, 2014.	
(d)	The Trust holds 40% of equity shares in an unlisted company and the financial position of said unlisted company as on date of merger is as under :	
	Book value of assets (other than immovable property)	25 lakhs
	Fair Market value of Immovable Property	45 lakhs
	Reserves and Surplus	15 lakhs

Provision for taxation	5 lakhs
Total amount of Paid-up Equity Share Capital	25 lakhs
Liabilities:	
(e) Liability in respect of shares and securities (unlisted)	8 lakhs
(f) Bank Liability in respect of quoted shares and securities	15 lakhs
(g) Advance Tax paid	12 lakhs

Compute the tax liability, if any, of Charitable Trust, arising out of above merger, giving explanation for treatment of each item in the context of relevant provisions contained in the Act. Assume that the trust has no tax liability in respect of other activities undertaken during previous year 2019-20.

Answer

Computation of exit tax payable by GVB Charitable Trust

Particulars		Amount (₹)
Aggregate FMV of total assets as on 31.3.2020, being the specified date (date of merger) **[See Working Note 1]**		1,08,00,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**		23,00,000
Accreted Income		**85,00,000**
Tax Liability@34.944% of ₹ 85,00,000		29,70,240
Working Note 1		
Aggregate fair market value of total assets on the specified date		
Share and securities held by the trust, which are acquired out of agricultural income exempt u/s 10(1) shall be ignored by virtue of proviso to section 115TD(2).		Nil
Quoted shares and securities [The fair market value of quoted shares would be average of the lowest and highest price of such shares quoted on the recognized stock exchange on the specified date i.e., 31.3.2020]		40,00,000
Land and building, being immovable property [The fair market value of land and building would be higher of ₹ 40,00,000 i.e., price that it would ordinarily fetch if sold in the open market as per registered valuer's certificate and ₹ 38,00,000, being stamp duty value as on the specified date i.e., 31.3.2020]		40,00,000
Equity shares in an unlisted company:		
Book value of assets (other than immovable property)	25,00,000	
Fair market value of immovable property	45,00,000	
	70,00,000	
Less: Book value of liabilities in the balance sheet: [Provision for taxation not to be included in the liabilities; total amount of paid up share capital and reserves and surplus would also not be included in liabilities]	Nil	
	70,00,000	
Value of unlisted shares held by GVB Charitable trust [70,00,000 x 40%]		28,00,000
		1,08,00,000

Working Note 2

Particulars	Amount (in ₹)
Total liability	
Liability in respect of unlisted shares and securities	8,00,000

Bank liability in respect of quoted shares and securities	15,00,000
Total liability of Charitable Trust	**23,00,000**

Question 29

Helpage is a charitable trust set up on 1.4.2010 with the object of providing relief of the poor. Later on, in April, 2012, it changed its object to medical relief. It applied for registration on the basis of its new object, i.e., medical relief, on 1.9.2012 and was granted registration on 1.2.2013.
On 1.4.2019, Helpage got merged with M/s. Medicare (P) Ltd, a pharmaceutical company not entitled for registration under section 12AA. All the assets and liabilities of the erstwhile trust became the assets and liabilities of M/s. Medicare (P) Ltd. The trust appointed a registered valuer for the valuation of its assets and liabilities. From the following particulars (including the valuation report), calculate the tax liability in the hands of the trust arising as a result of such merger:

(i) Land

Location	Date of purchase	Stamp duty value on 1.4.2019	Value which the land would fetch, if sold in the open market on 1.4.2019	Book Value on 1.4.2019
		₹	₹	₹
Noida	1.9.2010	55 lakhs	58 lakhs	50 lakhs
Gurgaon	1.9.2013	100 lakhs	120 lakhs	110 lakhs

(ii) Shares

Type of shares	Date of purchase	Face value of each share	Purchas e price of each share	Price at which each share is quoted on BSE as on 1.4.2019		Open market value as on 1.4.2019#
				Highest price	Lowest price	
		₹	₹	₹	₹	₹
5000 Quoted equity shares of A Ltd.	1.5.2014	100	110	320	300	
2000 Preference shares of B Ltd.	1.9.2015	100	100	-	-	180

on the basis of report of Merchant Banker

(iii) Liabilities

Book value of liabilities on 1.4.2019 = ₹ 120 lakhs.
This includes –

(a) Corpus fund ₹ 12 Lakhs.
(b) Provision for taxation ₹ 8 lakhs; and
(c) Reserves and Surplus ₹ 18 lakhs

Answer

As per section 115TD, the accreted income of "Helpage", a charitable trust, registered under section 12AA which is merged with M/s Medicare (P) Ltd., an entity not entitled for registration under section 12AA, would be chargeable to tax at the rate of 34.944% [30% plus surcharge @12% plus cess@4%].

Computation of accreted income and tax liability in the hands of the Helpage trust arising as a result of merger with M/s. Medicare (P) Ltd.

Particulars	Amount (₹)
Aggregate FMV of total assets as on 1.4.2019, being the specified date (date of merger) **[See Working Note 1]**	1,39,10,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**	82,00,000
Accreted Income	**57,10,000**
Tax Liability @ 34.944% of ₹ 57,10,000 (rounded off)	**19,95,300**
Working Notes:	
(1) Aggregate fair market value of total assets on the date of merger	
- **Land at Noida, being immovable property, purchased on 1.9.2010**	-
Since the trust was registered only on 1.2.2013 and benefit of section 11 and 12 was available to the trust only from A.Y.2013 - 14, relevant to P.Y.2012-13, being the previous year in which the application for registration is made, the value of land purchased in P.Y.2010-11, in respect of which benefit under sections 11 and 12 was not availed, has to be ignored for computing accreted income.	
- **Land at Gurgaon, being an immovable property, purchased on 1.9.2013** [The fair market value of land would be higher of ₹ 120 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and ₹ 100 lakhs, being stamp duty value as on the specified date, i.e., 1.4.2019]	1,20,00,000
- **Quoted equity shares of A Ltd. [5,000 x ₹ 310 per share]** [₹ 310 per share, being the average of the lowest (₹ 300) and highest price (₹ 320) of such shares on the specified date]	15,50,000
- **Preference shares of B Ltd. [2,000 x ₹ 180 per share]** [The fair market value which it would fetch if sold in the open market on the specified date i.e. FMV on 1.4.2019]	3,60,000
	1,39,10,000
(2) Total liability	
- Reserves and Surplus ₹ 18 lakhs [not includible]	-
- Corpus Fund of ₹ 12 lakhs [not includible]	-
- Provision for taxation ₹ 8 lakhs [not includible]	-
- Other Liabilities [₹120 lakhs - ₹18 lakhs - ₹12 lakhs - ₹8 lakhs]	82,00,000
	82,00,000

CHAPTER - 14
Tax Planning, Tax Evasion and Tax Avoidance

Section A – ICAI Study Material Questions

Question 1

Mr. Gavaskar sought voluntary retirement from a Government of India Undertaking and received compensation of ₹ 40 lacs on 31st January, 2019. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of ₹ 15 lacs, which would carry interest at 8% p.a. Gavaskar's wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of ₹ 5 lacs. Mr. Gavaskar would like to draw a monthly remuneration of ₹ 40,000 and also interest @ 10% p.a. on his capital in the business. Mr. Gavaskar has approached you for a tax efficient structure of the business.

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required.

Answer

The selection of the form of organisation to carry on any business activity is essential in view of the differential tax rates prescribed under the Income-tax Act, 1961 and specific concessions and deductions available under the Act in respect of different entities. For the purpose of formulating advice as to the tax efficient structure of the business, it is necessary for the tax consultant to consider the following issues:

(i) In the case of sole proprietary concern, interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1) as the expenditure is of personal nature. On the other hand, in the case of partnership firm, both interest on capital and remuneration payable to partners are allowable under section 37(1) subject to the conditions and limits laid down in section 40(b). The partnership should be evidenced by an instrument and the individual share of partners should be specified in the instrument. Remuneration and interest should however, be authorised by the instrument of partnership and paid in accordance with such instrument. Such interest and salary shall be taxable in the hands of partners to the extent the same is allowed as deduction in the hands of the firm under section 40(b). Interest to partners can be allowed up to 12% on simple interest basis, while the limit for allowability for partners' remuneration is based on book profit under section 40(b). As per section 40(b)(v), partners' remuneration shall be allowed to the extent of aggregate of -

   (a) On the first ₹ 3,00,000 of book profit or in case of loss – ₹ 1,50,000 or at the rate of 90% of book profits, whichever is more
   (b) On the balance of book profit – at the rate of 60%

   Note – However, if the firm is eligible to opt for presumptive taxation under section 44AD, 8% of gross receipts or 6% of gross receipts, as the case may be, would be deemed as its income. All deductions under section 30 to 37 are deemed to be allowed. No deduction is allowable, including deduction for partner's remuneration and interest on capital.

(ii) Partner's share in the profits of firm is not taxed in the hands of the partners by virtue of section 10(2A).

(iii) If a proprietary concern is formed, the salary of Mrs. Gavaskar shall be allowed as deduction under section 37(1).

(iv) The possibility of invoking section 40A(2) cannot be ruled out as salary is payable to a relative, who is an interested person within the meaning of section 40A(2). However, it can be argued successfully that salary of ₹ 5 lacs is justified in view of her long experience as marketing manager of a multinational company and the fair market value of services to be rendered by her to the concern.

(v) An issue arises as to whether remuneration of Mrs. Gavaskar would be includible in the total income of Mr. Gavaskar. Under section 64(1)(ii), remuneration of the spouse of an individual working in a concern in which the individual is having a substantial interest shall be included in the total income of the individual. However, the clubbing provision does not apply if the spouse possesses technical or professional qualification and the income is solely attributable to the application of his or her technical or professional knowledge and experience. Further, technical or professional qualification would not necessarily mean the qualifications obtained by degree or diploma of any recognized body [Batta Kalyani vs. CIT (1985) 154 ITR 0059 (AP)]. The experience of Mrs. Gavaskar as a marketing manager in a multinational company for 15 years may reasonably be considered as a professional qualification for this purpose.

(vi) If Mrs. Gavaskar joins the proprietary concern or partnership concern of her husband as employee, remuneration of ₹ 5 lacs shall be taxed in her hands under the head "salary".

(vii) lf she joins as partner in the business, remuneration shall be taxed in her hand as business income under section 28 to the extent such remuneration is allowed in the hands of the firm under section 40(b).

(viii) The tax rate applicable to an individual depends on the level of his/her income, whereas for partnership firms it is flat rate at 30%. Surcharge @ 12% would be attracted only if total income exceeds ₹ 1 crore. For individuals, the rate of tax is 5% on income exceeding ₹ 2.50 lakhs but not exceeding ₹ 5 lakhs; 20% for total income exceeding ₹ 5 lakhs but not exceeding ₹ 10 lakhs and @ 30% in respect of income exceeding ₹ 10 lakhs for the assessment year 2020-21. The surcharge for total income exceeding ₹ 50 lakhs but not exceeding ₹ 1 crore is 10% of tax payable; for total income exceeding ₹ 1 crore but not exceeding ₹ 2 crore is 15% of tax payable; for total income exceeding ₹ 2 crore but not exceeding ₹ 5 crore is 25% of tax payable and for total income exceeding ₹ 5 crore is 37% of tax payable . Health and Education cess @ 4% on income-tax plus surcharge, if applicable, is attracted in all the cases.

Question 2

Distinguish between Tax planning and Tax Evasion

Answer

Tax planning is carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimizing tax liability. Tax planning is an arrangement by which full advantage is taken of the concessions and benefits conferred by the statute, without violation of legal provisions. Tax evasion on the other hand is an attempt to reduce tax liability by dubious or artificial methods or downright fraud. It is illegal and denies State its legitimate share of tax.

Question 3

Specify with reason, whether the following acts can be considered as (i) Tax planning; or (ii) Tax management; or (iii) Tax evasion.

(i) Mr. P deposits ₹ 1,00,000 in PPF account so as to reduce his total income from ₹ 5,90,000 to ₹ 4,90,000.

(ii) SQL Ltd. maintains register of tax deduction at source effected by it to enable timely compliance.

(iii) An individual tax payer making tax saver deposit of ₹ 1,00,000 in a nationalised bank.

(iv) A partnership firm obtaining declaration from lenders/depositors in Form No. 15G/15H and forwarding the same to income-tax authorities.

(v) A company installed an air-conditioner costing ₹ 75,000 at the residence of a director as per terms of his appointment but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.

(vi) RR Ltd. issued a credit note for ₹ 80,000 as brokerage payable to Mr. Ramana who is the son of the managing director of the company. The purpose is to increase the total income of Mr. Ramana from ₹ 4,20,000 to ₹ 5,00,000 and reduce the income of RR Ltd. correspondingly.

(vii) A company remitted provident fund contribution of both its own contribution and employees' contribution on monthly basis before due date.

Answer

Tax Planning / Tax Management / Tax Evasion

	Answer	Reason
1.	Tax planning	Depositing money in PPF and claiming deduction under section 80C is as per the provisions of law.
2.	Tax management	Maintaining register of payments subject to TDS helps in complying with the obligations under the Income-tax Act, 1961.
3.	Tax planning	Making a tax saver deposit of ₹ 1,00,000 in a nationalized bank for claiming deduction under section 80C by an individual is a permitted tax planning measure under the provisions of income-tax law.
4.	Tax management	Obtaining declaration from lenders/depositors in Form No. 15G/15H by a partnership firm and forwarding the same to Income-tax authorities is in the nature of compliance of statutory obligation under the Income-tax Act, 1961.
5.	Tax evasion	An air conditioner fitted at the residence of a director as per the terms of his appointment would be a furniture qualifying for depreciation @10%, whereas an air conditioner fitted in a factory would be a plant qualifying for a higher depreciation @15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability. Treatment of air-conditioner fitted at the residence of a director as a plant fitted at the factory would tantamount to furnishing of false particulars with an attempt to evade tax.
6.	Tax evasion	Issuance of a credit note for ₹80,000 by RR Ltd. as brokerage payable to Mr. Ramana, the son of the Managing Director, to increase his total income from ₹ 4.2 lakh to ₹ 5.00 lakh and to correspondingly reduce the company's total income is a method of reducing the tax liability of the company by recording a fictitious transaction. The company is liable to tax at a flat rate of 30%/25%, as the case may be, whereas Mr. Ramana would not be liable to pay any tax, since his total income does not exceed ₹ 5,00,000, consequent to which he would be eligible for tax rebate of ₹ 12,500 under section 87A. Reducing tax liability by recording a fictitious transaction would tantamount to tax evasion.
7.	Tax management	Remitting of own contribution to provident fund and employees contribution to provident fund on a monthly basis before due date is proper compliance of the statutory obligations.

Question 4

Examine the doctrine of form and substance in the context of tax planning.

Answer

The following are certain principles enunciated by the Courts on the question as to whether it is the form or substance of a transaction, which will prevail in income-tax matters:

(i) **Form of transaction is to be considered in case of genuine transactions -** It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability whereas, if it is entered into in another form which is equally lawful, it may not. Therefore, in considering whether a transaction attracts tax or not, the form of the transaction put through is to be considered and not the substance. **However, this rule applies only to genuine transactions.** [CIT v. Motor and General Stores (P) Ltd. v. CIT (1967) 66 ITR 692(SC). Moreover, with General Anti Avoidance Rules coming into force with effect from A.Y.2017-18.

(ii) **True legal relation is the crucial element for taxability** - It is open for the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction. The taxing authority is entitled as well as bound to determine the true legal relation resulting from a transaction. The true legal relation arising from a transaction alone determines the taxability of a receipt arising from the transaction [CIT v. B.M. Kharwar (1969) 72 ITR 603 (SC)]

(iii) **Substance (i.e. actual nature of expense) is relevant and not the form –**

(a) In the case of an expenditure, the mere fact that the payment is made under an agreement does not preclude the department from enquiring into the actual nature of the payment [Swadeshi Cotton Mills Co. Ltd. v. CIT (1967) 63 ITR 57(SC)].

(b) In order to determine whether a particular item of expenditure is of revenue or capital nature, the substance and not merely the form should be looked into. [Assam Bengal Cement Co. Ltd. v. CIT (1955) 27 ITR 34 (SC)].

Question 5

(a) The merger of a loss making company with a profit making one results in losses setting off profits, a lower net profit and lower tax liability for the merged company. Would the losses be disallowed by applying GAAR?

(b) In the above facts, let us presume, the profit making company merges with a loss making one. This results in losses setting off profits, a lower net profit and lower tax liability for both companies taken together. Can this be examined under GAAR?

Answer

(a) As regards setting off of losses, the provisions relating to merger and amalgamation already contain specific anti-avoidance safeguards. Therefore, GAAR need not be invoked when SAAR is applicable, though as per CBDT Circular No. 7/2017 dated 27.01.2017, GAAR and SAAR can co-exist.

(b) In case of merger of a profit-making company with loss making company, there is no specific anti-avoidance safeguards. However, since such merger would be under the order of High Court, GAAR would not be invoked if the High Court has explicitly and adequately considered the tax implication while sanctioning the merger scheme.

Question 6

A choice is made by a company by acquiring an asset on lease over outright purchase. The company claims deduction for lease rentals in case of acquisition through lease rather than depreciation as in the case of purchase of the asset. Would the lease rent payment, being higher than the depreciation, be disallowed as expense under GAAR?

Answer

GAAR provisions would not apply in this case as the taxpayer merely makes a selection out of the options available to him.

Question 7

M/s Global Architects Inc is a company incorporated in country F1. It is engaged in the business of providing architectural design services all over the world. It receives an offer from Lovely Resorts Pvt Ltd, an Indian company, for design and development of resorts all over India.

India-F1 tax treaty provides that architectural services are technical services and payment for the same to a company may be taxed in India. However, if such professional services are provided by a firm or individual, then payment for such services are taxable only if the firm has a fixed base in India or stay of partners/ employees in India exceed 180 days.

M/s Global Architects Inc forms a partnership firm with a third party (director of the company) having only a nominal share in the F1. The firm enters into an agreement to carry out the services in India. The company seconded its trained manpower to the firm.

Thus, the partnership firm claimed the treaty benefit and no tax was paid in India. Can such an arrangement be examined under GAAR?

Answer

It is obvious that there was no commercial necessity to create a separate firm except to obtain the tax benefit. The firm was only on paper as the manpower was drawn from the company. The firm did not have any commercial substance. Moreover, it is a case of treaty abuse. Hence, GAAR may be invoked to disregard the firm and tax payment for architectural services as fee for technical services. However, the rate of tax on such payment shall be as applicable under the treaty, if more beneficial.

Question 8

An Indian holding company Holdco borrows ₹ 10 crore for acquisition of shares of Subco which then became subsidiary of Holdco. Holdco and Subco amalgamate so that the interest payable on the monies borrowed to acquire the shares can be deducted in computing the income from the business of the amalgamated company.

Answer

The borrowing by Holdco followed by the amalgamation by Subco is not abusive and GAAR would not apply in the case of merger which is carried out under the orders of High Court.

Section B – Additional Questions

Question 9

Examine whether General Anti-Avoidance Rules (GAAR) can be invoked to deny the treaty benefit in the following case, assuming that all other conditions prescribed for application of GAAR are being satisfied:-

X Pvt. Ltd., an Indian Company and Y Pvt. Ltd. (100% subsidiary of YAN Ltd.) located in country "A" formed a joint venture company XY Pvt. Ltd. in India on 01.04.2019. As per the joint venture agreement, 51% of shares are held by X Pvt. Ltd. and 49% are held by Y Pvt. Ltd in XY Pvt. Ltd. There is no other business activity in Y Pvt. Ltd.

Y Pvt. Ltd. is designated as Permitted Transferee of YAN Ltd. Permitted Transferee means though shares of XY Pvt. Ltd. are held by Y Pvt. Ltd. all rights of voting, management, right to sell etc. are vested with YAN Ltd.

On 19.03.2020, the shares held by Y Pvt. Ltd. in XY Pvt. Ltd. are sold to P Pvt. Ltd. which is a group company of X Pvt. Ltd. As per the tax-treaty between India and Country "A", there is no tax for capital gains either in source country or in Country "A". Consequently, the capital gains arising to Y Pvt. Ltd. are not taxable in India.

Answer

GAAR may, prima facie, apply, when the following twin conditions are satisfied:

- Main purpose of the arrangement being tax benefit, and
- Existence of tainted benefit.

As per the tax treaty between India and Country "A", there is no tax on capital gains either in the Source country or in Country "A". Consequently, the capital gains arising to Y Pvt. Ltd. is not taxable in India.

The arrangement of routing investment through Country "A" would result in a tax benefit. Since there is no business purpose in incorporating a company Y Pvt. Ltd. (100% subsidiary of YAN Ltd.) in Country "A", it can be said that the main purpose of the arrangement is to obtain a tax benefit.

On the question of whether the arrangement has any tainted element, it is evident that there is no commercial substance in incorporating Y Pvt. Ltd. as it does not have any effect on the business risk of YAN Ltd. or cash flow of YAN Ltd.

Additionally, the fact that all rights of shareholders of Y Pvt. Ltd. (designated as Permitted Transferee) are being exercised by YAN Ltd. instead of Y Pvt. Ltd, indicates that Y Pvt. Ltd lacks commercial substance.

As the twin conditions of main purpose being tax benefit and existence of a tainted element are satisfied, GAAR may be invoked in this case.

Question 10

MNO Ltd. in Mumbai is a wholly owned subsidiary of a holding company located in Low Tax Jurisdiction (LTJ). MNO Ltd. has accumulated profit of ₹ 1,500 lakhs. It deposited ₹ 1,000 lakhs in fixed deposit with a branch of foreign bank located in India. Based on the security of the deposit, the holding company located in ·LTJ availed bank loan of ₹ 800 lakhs. Is this an impermissible arrangement lacking commercial substance? Support your answer with applicable legal provisions.

Answer

This is an arrangement whose main purpose is to take money out of reserves available with subsidiary company i.e., MNO Ltd., India without payment of dividend distribution tax under

section 115-O.

The dividend distribution tax would be attracted in the hands of MNO Ltd. in both following situations -

- If MNO Ltd. had declared or distributed dividend, tax has to be paid@15% plus surcharge@12% plus health and education cess@4% (i.e., 17.472%) on such distributed income.
- If MNO Ltd. had directly lent money to its holding company, the provisions of section 2(22)(e) would get attracted, on account of deeming such amount of loan as dividend, since the holding company holds substantial interest in its Indian subsidiary, MNO Ltd. In such a case, dividend distribution tax@30% plus surcharge @12% plus health and education cess@4% (i.e. 34.944%) would be levied.

In order to avoid payment of dividend distribution tax, MNO Ltd. had adopted a circuitous route of depositing money with foreign bank's branch in India, so that the bank could loan the amount to the holding company.

Tax benefit [of ₹ 279.552 lakhs (₹ 800 lakhs x 34.944%)] is sought to be obtained by way of saving taxes on the amount distributed to the holding company which would be treated as deemed dividend and subject to dividend distribution tax in the hands of MNO Ltd. The arrangement disguises the source of funds by routing it through branch of a foreign bank. The branch of foreign bank may also be treated as an accommodating party.

Hence, the arrangement shall be deemed to be an impermissible arrangement lacking commercial substance.

However, in this case, since the tax benefit of ₹ 279.552 lakhs (₹ 800 lakhs x 34.944%) arising out of such arrangement does not exceed ₹ 3 crore, GAAR provisions cannot be invoked.

CHAPTER - 15
Deduction, Collection and Recovery of Tax

Section A – ICAI Study Material Questions

Question 1

LL Limited paid leave travel facility to its employees and considered exemption under section 10(5), based on the self-declaration furnished by the employees. The Assessing Officer held that the company as an employer ought to have verified the genuineness of the claim of exemption by obtaining from them, the proof of actual expenditure incurred by availing leave travel facility. Accordingly, the Assessing Officer treated the assessee company as assessee in default. Decide the correctness of action.

Answer

Section 192 casts liability on the employer to deduct tax at source from the salary paid to its employees.

In this case, the employer has paid leave travel concession / facility to its employees and the said concession / facility would be eligible for exemption subject to the conditions laid down in section 10(5) read with Rule 2B of the Income-tax Rules, 1962.

Section 192(2D) casts responsibility on the person responsible for paying any income chargeable under the head 'Salaries' to obtain from the assessee, the evidence or proof or particulars of prescribed claims under the provisions of the Act in the prescribed form and manner for the purposes of –

(1) estimating income of the assesses; or
(2) computing tax deductible under section 192(1).

Rule 26C of the Income-tax Rules, 1962 mandates a salaried assessee claiming, inter alia, leave travel concession or assistance to furnish evidence of expenditure incurred in relation thereto to the person responsible for making such for payment under section 192(1), for the purpose of estimating his income for computing the tax deductible under section 192.

Thus, the action of the Assessing Officer is correct in law.

Question 2

Mr. Sharma, an employee of M/s. ABC Ltd. since 10-04-2016 resigned on 31-03-2020 and withdrew ₹ 60,000 being the balance in his EPF account. Discuss with reasons whether the provisions of Chapter XVII-B are attracted and if so, what is the net amount receivable by the payee, Mr. Sharma?

Answer

As per section 192A, in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income owing to the provisions of Rule 8 of Part A of the Fourth Schedule not being applicable, the trustees of the Employees Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax@10% at the time of payment of accumulated balance due to the employee. Tax deduction at source has to be made only if the amount of such payment or aggregate amount of such payment of the payee is ₹ 50,000 or more.

Rule 8 of Part A of the Fourth Schedule, inter alia, provides that only if an employee has rendered continuous service of five years or more with employer, then accumulated balance in a recognized provident fund payable to an employee would be excluded from total income of that employee.

In the present case, Mr. Sharma has withdrawn an amount exceeding ₹ 50,000 on his resignation after rendering a continuous service of four years with M/s. ABC Ltd. Therefore, tax has to be deducted at source@10% under section 192A on ₹ 60,000, being the amount withdrawn on his resignation without rendering continuous service of a period of five years with M/s. ABC Ltd.

The net amount receivable by Mr. Sharma is ₹ 54,000 [i.e., ₹ 60,000 – ₹ 6,000, being tax deducted at source].

Note – It is assumed that Mr. Sharma has furnished his permanent account number (PAN) to the person responsible for deducting tax at source. Otherwise, tax would be deductible at the maximum marginal rate. It may be noted that with effect from 1.6.2015 such employee can furnish declaration in Form No.15G for non-deduction of tax at source under section 192A by virtue of section 197A(1A).

Question 3

Examine the TDS implications under section 194A in the cases mentioned hereunder –

(i) On 1.10.2019, Mr. Harish, aged 40 years, made a six-month fixed deposit of ₹ 10 lakh @9% p.a. with ABC Co-operative Bank. The fixed deposit matures on 31.3.2020.

(ii) On 1.6.2019, Mr. Ganesh, aged 45 years, made three nine month fixed deposits of ₹ 3 lakh each carrying interest@9% with Dwarka Branch, Janakpuri Branch and Rohini Branch of XYZ Bank, a bank which has adopted CBS. The fixed deposits mature on 28.2.2020.

(iii) On 1.4.2019, Mr. Rajesh, aged 35 years, started a 1 year recurring deposit of ₹ 80,000 per month@8% p.a. with PQR Bank. The recurring deposit matures on 31.3.2020.

Answer

(i) ABC Co-operative Bank has to deduct tax at source@10% on the interest of ₹ 45,000 (9% × ₹ 10 lakh × ½) under section 194A. The tax deductible at source under section 194A from such interest is, therefore, ₹ 4,500.

(ii) XYZ Bank has to deduct tax at source@10% under section 194A, since the aggregate interest on fixed deposit with the three branches of the bank is ₹ 60,750 [₹ 3,00,000 × 3 × 9% × 9/12], which exceeds the threshold limit of ₹ 40,000. Since XYZ Bank has adopted CBS, the aggregate interest credited/paid by all branches has to be considered. Since the aggregate interest of ₹ 60,750 exceeds the threshold limit of ₹ 40,000, tax has to be deducted@10% under section 194A.

(iii) Tax has to be deducted under section 194A by PQR Bank on the interest of ₹ 41,600 falling due on recurring deposit on 31.3.2020 to Mr. Rajesh, since –

  (1) "recurring deposit" is included in the definition of "time deposit"; and

  (2) such interest exceeds the threshold limit of ₹ 40,000.

Question 4

Maya Bank credited ₹ 73,50,000 towards interest on the deposits in a separate account for macro-monitoring purposes by using Core-branch Banking Solutions (CBS) software. No tax was deducted at source in respect of interest on deposits so credited even where the interest in respect of some depositors exceeded the limit of ₹ 40,000.

The Assessing Officer disallowed 30% of interest expenditure, where the interest on time deposits credited exceeded the limit of ₹ 40,000 and also levied penalty under section 271C.

Decide the correctness of action of the Assessing Officer.

Answer

The Explanation below section 194A(1) provides that where any income by way of interest other than interest on securities is credited to any account, whether called 'interest payable account' or 'suspense account' or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and provisions of section 194A, shall, thus, apply.

However, the CBDT has, vide Circular No.3/2010 dated 2.3.2010, clarified that Explanation to section 194A will not apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software.

Since no constructive credit to the depositor's / payee's account takes place while calculating interest on daily / monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only.

In such cases, tax shall be deducted at source on accrual of interest at the end of the financial year or at periodic intervals as per practice of the bank or as per the depositor's or payee's requirement or on maturity or on encashment of time deposit, whichever event takes place earlier and wherever the aggregate amount of interest income credited or paid or likely to be credited or paid during the financial year by the bank exceeds the limits specified in section 194A i.e., ₹40,000.

In view of the above, the action of the Assessing Officer in disallowing the interest expenditure credited in a separate account for macro monitoring purpose is not valid and consequent initiation of penalty proceedings under section 271C is not tenable in law.

Question 5

Mr. Govind won the first prize in a lottery ticket and the prize was a Maruti car worth ₹ 5 lacs. What is the procedure to be adopted before handing over the Maruti Car to Mr. Govind?

Answer

Section 194B provides that the person responsible for paying to any person, any income by way of winnings from any lottery or crossword puzzle, card game or any other game of any sort and the amount of winning exceeds ₹ 10,000, tax shall be deducted at source @30%.

However, in case where the winning is wholly in kind, the person responsible for paying the prize shall before releasing the winning, ensure that the tax has been paid in respect of such winning.

The Karnataka High Court in the case of CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1 has held that where the winnings are wholly in kind, the responsibility cast under section 194B is to ensure that the tax is paid by the winner of the prize before the prize is released in his favour. In this regard, the CBDT Circular No.763 dated 18/2/1998 clarifies that the person responsible for paying the winnings shall, before releasing such winnings, ensure that the tax is paid by the winner. He can do so, for example, by collecting from the winner a sum equal to the tax deductible at source on the winnings in kind, before releasing the winnings. For this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind.

Therefore, in this case since the entire winning is in kind, it must be ensured that the sum equal to the tax deductible at source (i.e., ₹ 1,50,000, being @ 30% of ₹ 5 lacs) is paid by Mr. Govind, before the car is released in his favour. This can be done by collecting ₹ 1,50,000 from Mr. Govind before releasing the Maruti car to him and remitting the said sum to the Government account or verifying the tax payment by the winner and thereafter releasing the prize.

Question 6

ABC Ltd. makes the following payments to Mr. X, a contractor, for contract work during the P.Y.2019-20–
₹ 20,000 on 1.5.2019
₹ 25,000 on 1.8.2019
₹ 28,000 on 1.12.2019

On 1.3.2020, a payment of ₹ 30,000 is due to Mr. X on account of a contract work.

Discuss whether ABC Ltd. is liable to deduct tax at source under section 194C from payments made to Mr. X.

Answer

In this case, the individual contract payments made to Mr. X does not exceed ₹ 30,000. However, since the aggregate amount paid to Mr. X during the P.Y.2019-20 exceeds ₹ 1,00,000 (on account of the last payment of ₹ 30,000, due on 1.3.2020, taking the total from ₹ 73,000 to ₹ 1,03,000), the TDS provisions under section 194C would get attracted. Tax has to be deducted@1% on the entire amount of ₹ 1,03,000 from the last payment of ₹ 30,000 and the balance of ₹ 28,970 (i.e., ₹ 30,000 – ₹1,030) has to be paid to Mr. X.

Question 7

Bharathi Cements Ltd. purchased jute bags from Raj Kumar & Co. The latter has to supply the jute bags with the logo and address of the assessee, printed on it. From 01.09.2019 to 20.03.2020, the value of jute bags supplied is ₹ 8,00,000, for which the invoice has been raised on 20.03.2020. While effecting the payment for the same, is the assessee bound to deduct tax at source, assuming that the value of the printing component involved is ₹ 1,10,000. You are informed that the assessee has not sold any material to Raj Kumar & Co. and that the latter has to manufacture the jute bags in its plant using raw materials purchased by it from outsiders.

Answer

As per the definition under section 194C, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer. This is regardless of the quantum of expenditure incurred towards printing or processing comprised in the bill amount.

The problem clearly states that Raj Kumar & Co. has to manufacture the jute bags using raw materials purchased from outsiders and that the assessee Bharathi Cements Ltd has not sold any material to them. Therefore, in this case, it is a contract of sale. Hence, the provisions of section 194C are **not** attracted and no liability to deduct tax at source would arise.

Question 8

Alap Ltd. has made following payments on various dates in financial year 2019-20 to Vilambit Ltd. towards work done under different contracts:

Contract Number	Date of payment	Amount (₹)
1.	5.5.2019	20,000
2.	6.6.2019	15,000
3.	8.8.2019	25,000

4.	10.12.2019	25,000
5.	29.01.2020	17,000

Alap Ltd. claims that it is not liable for deduction of tax at source under section 194C. Examine the correctness of the claim made by the company. What would be the position if the value of the contract no. 5 is ₹ 14,000 only and there was no further contract during the year?

Answer

As per section 194C(5), tax has to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds ₹ 30,000 in a single payment or ₹ 1,00,000 in aggregate during the financial year.

Therefore, in the given case, even though the value of each individual contract does not exceed ₹ 30,000, the aggregate amount exceeds ₹ 1,00,000. Hence, Alap Ltd's contention is not correct and tax is required to be deducted at source on the whole amount of ₹ 1,02,000 from the last payment of ₹17,000 towards Contract No.5 on account of which the aggregate amount exceeded ₹ 1,00,000.

However, no tax deduction is to be made if the value of the last contract is ₹ 14,000 as the aggregate amount in such case would only be ₹ 99,000, which is below the aggregate monetary limit of ₹ 1,00,000.

Question 9

Examine the applicability of the provisions for tax deduction at source under section 194DA in the following cases -

(i) Mr. X, a resident, is due to receive ₹ 4.50 lakhs on 31.3.2020, towards maturity proceeds of LIC policy taken on 1.4.2017, for which the sum assured is ₹ 4 lakhs and the annual premium is ₹ 1,10,000.

(ii) Mr. Y, a resident, is due to receive ₹ 3.25 lakhs on 31.3.2020 on LIC policy taken on 31.3.2012, for which the sum assured is ₹ 3 lakhs and the annual premium is ₹ 35,000.

(iii) Mr. Z, a resident, is due to receive ₹ 95,000 on 1.8.2019 towards maturity proceeds of LIC policy taken on 1.8.2013 for which the sum assured is ₹ 90,000 and the annual premium is ₹ 12,000.

Answer

(i) Since the annual premium exceeds 10% of sum assured in respect of a policy taken after 31.3.2012, the maturity proceeds of ₹ 4.50 lakhs due on 31.3.2020 are not exempt under section 10(10D) in the hands of Mr. X. Therefore, tax is required to be deducted@5% under section 194DA on the amount of income comprised therein i.e., on ₹ 1,20,000 (₹ 4,50,000, being maturity proceeds - ₹ 3,30,000, being the entire amount of insurance premium paid).

(ii) Since the annual premium is less than 20% of sum assured in respect of a policy taken before 1.4.2012, the sum of ₹ 3.25 lakhs due to Mr. Y would be exempt under section 10(10D) in his hands. Hence, no tax is required to be deducted at source under section 194DA on such sum payable to Mr. Y.

(iii) Even though the annual premium exceeds 10% of sum assured in respect of a policy taken after 31.3.2012, and consequently, the maturity proceeds of ₹ 95,000 due on 1.8.2019 would not be exempt under section 10(10D) in the hands of Mr. Z, the tax deduction provisions under section 194DA are not attracted since the maturity proceeds are less than ₹ 1 lakh.

Question 10

Calculate the amount of tax to be deducted at source (TDS) on payment made to Ricky Ponting, an Australian cricketer, by a newspaper for contribution of articles ₹ 25,000.

Answer

Under section 194E, the person responsible for payment of any amount to a non-resident sportsman for contribution of articles relating to any game or sport in India in a newspaper shall deduct tax @20%. Further, since Ricky Ponting is a non-resident, health and education cess@4% on TDS would also be added.
Therefore, tax to be deducted = ₹ 25,000 x 20.80% = ₹ 5,200.

Question 11

B. Airways Ltd. sold tickets to the travel agents in India at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price but not exceeding the maximum published price. Commission at the rate of 9% of minimum fixed commercial price was deducted under section 194H by the company. The Assessing Officer contended that the liability for tax deduction at source is attracted on the difference between the minimum fixed commercial price and the maximum published price by treating it as "additional special commission" in the hands of the agents.
Is the contention of Assessing Officer tenable in law?

Answer

As per the provisions of section 194H, a person is liable to deduct tax at source at the time of credit or payment of commission to any resident, whichever is earlier.

In the present case, B. Airways Ltd. correctly deducted tax at source under section 194H from the commission@9% of the minimum fixed commercial price paid to the travel agents, who were allowed to sell the air tickets at any price higher than the minimum fixed commercial price subject to a maximum published price. However, the Assessing Officer contented that the airline company was required to deduct tax at source on the difference between the minimum fixed commercial price and the maximum published price by treating it as “additional special commission” in the hands of the agents.
The facts of the case are similar to the case of CIT v. Qatar Airways (2011) 332 ITR 253, where the Bombay High Court held that the difference between the maximum published price and the minimum fixed commercial price cannot be taken as “additional special commission” in the hands of the agents. This is because the maximum published price is the maximum price and the airline company has granted permission to the agents to sell the tickets at a price lower than the maximum published price. Further, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents. In order to deduct tax at source on the difference between actual sale price and minimum fixed commercial price, the exact income in the hands of the agents must be ascertainable by the airline company. However, it is not so ascertainable in this case, since the agents are given discretion to sell the tickets at any rate between the minimum fixed commercial price and the maximum published price. **It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of the price at which the tickets were sold by them.**

Applying the rationale of the above case to the case on hand, B. Airways Ltd. is not liable to deduct tax at source under section 194H on the difference between the maximum published price and the minimum fixed commercial price, even though the amount earned by the agent over and above the minimum fixed commercial price is taxable as income in their hands.
Therefore, the contention of the Assessing Officer is not tenable in law.

Question 12

Moon TV, a television channel, made payment of ₹ 50 lakhs to a production house for production of programme for telecasting as per the specifications given by the channel. The copyright of the programme is also transferred to Moon TV. Would such payment be liable for tax deduction at source under section 194C? Discuss.

Also, examine whether the provisions of tax deduction at source under section 194C would be attracted if the payment was made by Moon TV for acquisition of telecasting rights of the content already produced by the production house.

Answer

In this case, since the programme is produced by the production house as per the specifications given by Moon TV, a television channel, and the copyright is also transferred to the television channel, the same falls within the scope of definition of the term 'work' under section 194C. Therefore, the payment of ₹ 50 lakhs made by Moon TV to the production house would be subject to tax deduction at source under section 194C.

If, however, the payment was made by Moon TV for acquisition of telecasting rights of the content already produced by the production house, there is no contract for ''carrying out any work", as required in section 194C(1). Therefore, such payment would not be liable for tax deduction at source under section 194C.

Question 13

ABC Ltd. took on sub-lease a building from J, an individual, with effect from 1.9.2019 on a rent of ₹ 25,000 per month. It also took on hire machinery from J with effect from 1.10.2019 on hire charges of ₹ 15,000 per month. ABC Ltd. entered into two separate agreements with J for sub-lease of building and hiring of machinery. The rent of building and hire charges of machinery for the financial year 2019-20 were ₹ 1,75,000 and ₹ 90,000, respectively, which were credited by ABC Ltd. to the account of J in its books of account on 31.3.2020. Examine the obligation of ABC Ltd. with regard to deduction of tax at source in respect of the rent and hire charges.

Answer

As per section 194-I dealing with deduction of tax at source from payment of rent, the rate of TDS applicable is 2% for machinery hire charges and 10% for building lease rent. The scope of the section includes within its ambit, rent for machinery, plant and equipment. Tax is required to be deducted at source from payment of rent, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of building and machinery, irrespective of whether such assets are owned or not by the payee.

The limit of ₹ 2,40,000 for tax deduction at source will apply to the aggregate rent of all the assets. Even if two separate agreements are entered into, one for sub-lease of building and another for hiring of machinery, rent and hire charges under the two agreements have to be aggregated for the purpose of application of the threshold limit of ₹ 2,40,000. In this case, since the payment for rent and hire charges credited to the account of J, the payee, aggregates to ₹ 2,65,000 (₹ 1,75,000 + ₹ 90,000), tax is deductible at source under section 194-I. Tax is deductible@10% on ₹ 1,75,000 (rent of building) and @2% on ₹ 90,000 (hire charges of machinery).

Question 14

Mr. X sold his house property in Bangalore as well as his rural agricultural land for a consideration of ₹ 60 lakh and ₹ 15 lakh, respectively, to Mr. Y on 1.8.2019. He has purchased the house property

and the land in the year 2018 for ₹ 40 lakh and ₹ 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 1.8.2019, is ₹ 85 lakh and ₹ 20 lakh for the house property and rural agricultural land, respectively. Determine the tax implications in the hands of Mr. X and Mr. Y and the TDS implications, if any, in the hands of Mr. Y, assuming that both Mr. X and Mr. Y are resident Indians.

Answer

(i)	**Tax implications in the hands of Mr. X**
	As per section 50C, the stamp duty value of house property (i.e. ₹ 85 lakh) would be deemed to be the full value of consideration arising on transfer of property since stamp duty value exceeds 105% of the actual consideration. Therefore, ₹ 45 lakh (i.e.,
	₹ 85 lakh – ₹ 40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2020-21. Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. X.
(ii)	**Tax implications in the hands of Mr.Y**
	In case immovable property is received for inadequate consideration, the difference between the stamp value and actual consideration would be taxable under section 56(2)(x), if such difference exceeds higher of ₹ 50,000 or 5% of the consideration. Therefore, in this case ₹ 25 lakh (₹ 85 lakh – ₹ 60 lakh) would be taxable in the hands of Mr. Y under section 56(2)(x). Since agricultural land is not a capital asset, the provisions of section 56(2)(x) are not attracted in respect of receipt of agricultural land for inadequate consideration, since the definition of "property" under section 56(2)(x) includes only capital assets specified thereunder.
(iii)	**TDS implications in the hands of Mr. Y**
	Since the sale consideration of house property exceeds ₹ 50 lakh, Mr. Y is required to deduct tax at source under section 194-IA. The tax to be deducted under section 194- IA would be ₹ 60,000, being 1% of ₹ 60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

Question 15

Mr. X, a salaried individual, pays rent of ₹ 55,000 per month to Mr. Y from June, 2019. Is he required to deduct tax at source? If so, when is he required to deduct tax? Also, compute the amount of tax to be deducted at source.
Would your answer change if Mr. X vacated the premises on 31st December, 2019?
Also, what would be your answer if Mr. Y does not provide his PAN to Mr. X?

Answer

Since Mr. X pays rent exceeding ₹ 50,000 per month in the F.Y. 2019-20, he is liable to deduct tax at source @5% of such rent for F.Y. 2019-20 under section 194-IB. Thus, ₹ 27,500 [₹ 55,000 x 5% x 10] has to be deducted from rent payable for March, 2020.

If Mr. X vacated the premises in December, 2019, then tax of ₹ 19,250 [₹ 55,000 x 5% x 7] has to be deducted from rent payable for December, 2019.

In case Mr. Y does not provide his PAN to Mr. X, tax would be deductible @20%, instead of 5%.

In case 1 above, this would amount to ₹ 1,10,000 [₹ 55,000 x 20% x 10] but the same has to be restricted to ₹ 55,000, being rent for March, 2020.

In case 2 above, this would amount to ₹ 77,000 [₹ 55,000 x 20% x 7] but the same has to be restricted to ₹ 55,000, being rent for December, 2019.

Question 16

XYZ Ltd. makes a payment of ₹ 28,000 to Mr. Ganesh on 2.8.2019 towards fees for professional services and another payment of ₹ 25,000 to him on the same date towards fees for technical services. Discuss whether TDS provisions under section 194J are attracted.

Answer

TDS provisions under section 194J would not get attracted, since the limit of ₹ 30,000 is applicable for fees for professional services and fees for technical services, separately. It is assumed that there is no other payment to Mr. Ganesh towards fees for professional services and fees for technical services during the P.Y.2019-20.

Question 17

East Bengal Club, a renowned football club, has engaged Raghu, a resident in India, as its coach at a remuneration of ₹ 6 lacs per annum. The club wants to know from you whether it is liable to deduct tax at source from such remuneration.

Answer

Section 194J requires deduction of tax at source @10% from the amount credited or paid by way of fees for professional services, where such amount or aggregate of such amounts credited or paid to a person exceeds ₹ 30,000 in a financial year. As per Explanation (a) to section 194J, professional services includes services rendered by a person in the course of carrying on such other profession as is notified by the CBDT for the purposes of section 194J.

Accordingly, the CBDT has, vide Notification No.88 dated 21.8.2008, in exercise of the powers conferred by clause (a) of the Explanation to section 194J notified the services rendered by coaches and trainers in relation to sports activities as professional services for the purposes of section 194J.

Therefore, the club is liable to deduct tax at source under section 194J from the remuneration payable to the Coach, Raghu.

Question 18

Examine whether TDS provisions would be attracted in the following cases, and if so, under which section. Also, specify the rate of TDS applicable in each case. Assume that all payments are made to residents.

	Particulars of the payer	Nature of payment	Aggregate of payments made in the F.Y.2019-20
1	Mr. Ganesh, an individual carrying on retail business with turnover of ₹ 2.5 crores in the P.Y.2018-19	Contract Payment for repair of residential house	₹ 5 lakhs
		Payment of commission to Mr. Vallish for business purposes	₹ 80,000
2.	Mr. Rajesh, a wholesale trader who declares profits under section 44AD for P.Y.2018-19 & P.Y.2019-20.	Contract Payment for reconstruction of residential house (made during the period January-March, 2020)	₹ 20 lakhs in January, 2020, ₹ 15 lakhs in Feb 2020 and ₹ 20 lakhs in March 2020.
3.	Mr. Satish, a salaried individual	Payment of brokerage for buying a residential house in March, 2020	₹ 51 lakhs

4.	Mr. Dheeraj, a pensioner	Contract payment made during October-November 2019 for reconstruction of residential house	₹ 48 lakhs

Answer

	Particulars of the payer	Nature of payment	Aggregate of payments in F.Y.2019-20	Whether TDS provisions are attracted?
1	Mr. Ganesh, an individual carrying on retail business with turnover of ₹ 2.5 crores in the P.Y.2018-19	Contract Payment for repair of residential house	₹5 lakhs	No, TDS u/s 194C is not attracted since the payment is for personal purpose and TDS u/s 194M is not attracted as aggregate of contract payment to the payee in the P.Y.2019-20 does not exceed ₹ 50 lakh.
		Payment of commission to Mr. Vallish for business purposes	₹ 80,000	Yes, u/s 194H, since the payment exceeds ₹ 15,000, and Mr. Ganesh's turnover exceeds ₹ 1 crore in the P.Y.2018-19.
2.	Mr. Rajesh, a wholesale trader who declares profits under section 44AD for P.Y.2018-19 and P.Y.2019-20.	Contract Payment for reconstruction of residential house	₹ 55 lakhs	Yes, u/s 194M, since the aggregate of payments (i.e., ₹ 55 lakhs) exceed ₹ 50 lakhs, and the payments are made after 1.9.2019. Since he declares profits on presumptive basis u/s 44AD, he is not subject to tax audit in the P.Y.2018-19. Hence, TDS provisions u/s 194C are not attracted in respect of payments made in the P.Y.2019-20.
3.	Mr. Satish, a salaried individual	Payment of brokerage for buying a residential house	₹51 lakhs	Yes, under section 194M, since the payment of ₹ 51 lakhs made in March 2020 exceeds the threshold of ₹ 50 lakhs. Since Mr. Satish is a salaried individual, the provisions of section 194H are not applicable in this case.
4.	Mr. Dheeraj, a pensioner	Contract payment for reconstruction of residential house	₹48 lakhs	TDS provisions u/s 194C are not attracted since Mr. Dheeraj is a pensioner and hence, not subject to tax audit. TDS provisions u/s 194M are also not applicable in this case, since the payment of ₹ 48 lakhs, even though made after 1.9.2019, does not exceed the threshold of ₹50 lakhs.

Question 19

'X' while making payment "net of tax" to a non-resident for providing technical services on a world bank aided project had deducted tax out of such payments as per rates prescribed but says that the payee is not entitled for the TDS certificate. Examine.

Answer

As per section 198, any sum deducted in accordance with the provisions of Chapter XVII-B of the Income-tax Act, 1961 is deemed to be income received while computing the income of the payee.

As per section 203, every person deducting tax at source shall furnish to the payee a certificate in the prescribed form within the prescribed time.

Even in a case where 'X undertakes to pay the tax on the grossed up amount, the non-resident shall be entitled for issue of certificate for tax deducted at source in respect of payment made 'net of tax' in terms of section 195A. This has been clarified vide CBDT Circular No.785 dated 24.11.1999.

Therefore, X has a legal obligation to issue TDS certificate to the non-resident, even if he has made payment of income "net of tax" to him.

Question 20

An amount of ₹ 40,000 was paid to Mr. X on 1.7.2019 towards fees for professional services without deduction of tax at source. Subsequently, another payment of ₹ 50,000 was due to Mr. X on 28.2.2020, from which tax @10% (amounting to ₹ 9,000) on the entire amount of ₹ 90,000 was deducted. However, this tax of ₹ 9,000 was deposited only on 22.6.2020. Compute the interest chargeable under section 201(1A).

Answer

(i) Interest under section 201(1A) would be computed as follows –

Particulars	₹
1% on tax deductible but not deducted i.e., 1% on ₹ 4,000 for 8 months	320
1½% on tax deducted but not deposited i.e. 1½% on ₹ 9,000 for 4 months[4]	540
	860

(ii) Such interest should be paid before furnishing the statements in accordance with section 200(3).

(iii) Where the payer fails to deduct the whole or any part of the tax on the amount credited or payment made to a **payee** and is not deemed to be an assessee-in-default under section 201(1) on account of payment of taxes by such **payee**, interest under section 201(1A)(i) i.e., @1% p.m. or part of month, shall be payable by the payer from the date on which such tax was deductible to the date of furnishing of return of income by such **payee**. The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the **payee.**

(iv) Where the tax has not been paid after it is deducted, the amount of the tax together with the amount of simple interest thereon shall be a charge upon all the assets of the person or the company, as the case may be.

Question 21

The Assessing Officer issued a notice of demand under section 156 to Mr. X on 1.10.2019 for payment of ₹ 15 lakhs towards his income-tax liability for the A.Y.2018-19, requiring him to pay the said amount within 30 days.

(a) Is he required to issue fresh notice of demand and if so, for what amount, in the following two cases (each case has to be considered independently) –

(i) If the tax demand is reduced to ₹ 12 lakhs by the Commissioner (Appeals) by issue of order under section 250;

(ii) If the tax demand is increased to ₹ 20 lakhs by the Appellate Tribunal, by issue of an order under section 254.

(b) How would the interest liability under section 220(2) be calculated if the tax demand is reduced to ₹ 12 lakhs by the Commissioner (Appeals) by issue of order under section 250 and subsequently increased to ₹ 15 lakhs by the Appellate Tribunal by way of issue of order under section 254?

Answer

(a) (i) No fresh notice of demand is required to be served on Mr. X. The Assessing Officer is only required to give an intimation of the fact of reduction of demand to ₹ 12 lakhs to Mr. X. The proceedings initiated on the basis of the original notice of demand may be continued in relation to the reduced amount of ₹ 12 lakhs from the stage at which such proceedings stood immediately before disposal of appeal.

(ii) A fresh notice of demand has to be given only in respect of ₹ 5 lakhs, being the amount of enhancement. Any proceedings in relation to ₹ 15 lakhs covered by the original notice of demand served upon Mr. X may be continued from the stage at which such proceedings stood immediately before disposal of appeal.

(b) The interest under section 220(2) has to be paid on ₹ 15 lakhs @1% per month or part of the month comprised in the period commencing from 1.11.2019 and ending with the date on which the amount is paid, assuming that Mr. X has not paid any interest so far.

Question 22

Mr. Madhusudan is regular in deducting tax at source and depositing the same. In respect of the quarter ended 31st December, 2019 a sum of ₹ 80,000 was deducted at source from the contractors. The statement of tax deducted at source under section 200 was filed on 23rd March, 2020 for the quarter ended 31.12.2019.

(i) Is there any delay on the part of Mr. Madhusudan in filing the statement of TDS?

(ii) If the answer to (i) above is in the affirmative, how much amount can be levied on Mr. Madhusudan for such default under section 234E?

(iii) Is there any remedy available to him for reduction/waiver of the levy?

Answer

(i) Yes, there has been a delay on the part of Mr. Madhusudan in filing the statement of TDS.

As per section 200(3) read with Rule 31A, the statement of tax deducted at source for the quarter ended 31st December, 2019 has to be filed on or before 31st January, 2020. However, the same has been filed only on 23rd March, 2020. Hence, there has been a 52 day delay on the part of Mr. Madhusudan in filing the statement of TDS.

(ii) As per section 234E of the Income-tax Act, 1961, where a person fails to file deliver or cause to be delivered the statement of tax deducted at source within the prescribed time, then, he shall be liable to pay, by way of fee, a sum of ₹ 200 for every day during which the failure continues.

The amount of fee shall not, however, exceed the amount of tax deductible.

In this case, since Mr. Madhusudhan has delayed filing the statement of TDS by 52 days, he would be liable to pay a fee of ₹ 10,400 (₹ 200 x 52 days) under section 234E. The said fee does not exceed the tax deductible (₹ 80,000, in this case).

(iii) The CBDT is empowered to issue general or special orders, whether by way of relaxation of any of the provisions of sections 139, 143, 144, 147 etc. or otherwise, in respect of any class of incomes or class of cases. The CBDT may issue such order(s) from time to time if it considers expedient so to do, for the purpose of proper and efficient management of the work of assessment and collection of revenue. Section 234E is included in the list of sections in respect of which the CBDT is empowered to issue order for relaxation of the provisions of the Act.

Hence, the remedy available to Mr. Madhusudhan is that he can file an application to the CBDT under section 119 and seek waiver/reduction of the penalty levied/leviable under section 234E.

Question 23

Smt. Vijaya, proprietor of Lakshmi Enterprises, made turnover of ₹ 210 lakhs during the previous year 2018-19. Her turnover for the year ended 31-3-2020 was ₹ 90 lakhs.

Decide whether provisions relating to deduction of tax at source are attracted for the following payments made during the financial year 2019-20:

(i) Purchase commission paid to one agent ₹ 25,000 on 13.6.2019 towards purchases made during the year.

(ii) Payments to Civil engineer of ₹ 5,00,000 for construction of residential house for self use.

Answer

Since Smt. Vijaya's turnover was ₹ 210 lakhs in the immediately preceding financial year (i.e., F.Y.2018-19), she is liable to deduct tax at source in the P.Y.2019-20, irrespective of her turnover being only ₹ 90 lakhs in the F.Y.2019-20.

(i) Tax@5% has to be deducted under section 194H in respect of purchase commission of ₹ 25,000 to an agent for purchases made during the year, since the same exceeds the threshold limit of ₹ 15,000 for non-deduction of tax at source thereunder.

(ii) Tax has to be deducted under section 194C in case of payment to resident contractors. The rate of tax is 1% if the payee is an individual or HUF and 2% in case of payees, other than individuals and HUFs.

However, as per section 194C(4), no individual or Hindu undivided family shall be liable to deduct income tax on the sum credited or paid to the account of the contractor where such sum is credited or paid exclusively for personal purposes of such individual or any member of the Hindu undivided family.

In this case, since Smt. Vijaya, an individual, makes payment of ₹ 5 lakh to a civil engineer for construction of residential house for self use, she is not liable to deduct tax at source under section 194C from such sum.

Question 24

What is the rate at which the tax is either to be deducted or collected under the provisions of the Act in the following cases?

(i) A partnership firm making sales of timber which was procured and obtained under a forest lease.

(ii) Payment of income of Rs.25 lakh on investments in securities to the Foreign Institutional Investor.

(iii) A nationalized bank receiving professional services from a registered society made provision on 31-03-2020 of an amount of ₹ 25 lakh against the service charges bills to be received.

(iv) Payment of ₹ 5 lakh made to Mr. Phelps who is an athlete by a manufacturer of a swim wear for brand ambassador.

Answer

Applicable Rate of TDS/TCS

Situation	TCS/TDS	Rate	Note
(i) Partnership firm selling timber obtained under forest lease	TCS	2.5%	1
(ii) Payment of income on investments in the securities to the Foreign Institutional Investors	TDS	20.8%	2
In case the securities are Government securities		5.20%	
(iii) Professional services rendered by a registered society to a nationalised bank	TDS	10%	3
(iv) Payment by a manufacturer of swim wear to its brand ambassador Mr. Phelps, an athlete	TDS		4
If Mr. Phelps is a resident		10%	
If Mr. Phelps is a non-resident		20.8%	

Notes:

(1) As per section 206C(1), tax has to be collected at source@2½% by the partnership firm, being a seller, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount, whichever is earlier.

(2) As per section 196D, tax has to be deducted at source @ 20.8% (20% plus cess@4%) by any person who is responsible for paying to a Foreign Institutional Investor, any income by way of interest on securities at the time of credit of such income to the account of the payee or at the time of payment of such income, whichever is earlier.

Alternatively, if the said securities are assumed to be government securities, tax is deductible@5.20% (i.e., 5% plus cess@4%) under section 194LD.

(3) Tax has to be deducted at source@10% under section 194J, by the nationalized bank at the time of credit of fees for professional services to the account of the registered society (i.e., on 31.3.2020), even though payment is to be made after that date.

(4) Tax has to be deducted at source@10% under section 194J[6] in respect of income of ₹ 5 lakh paid to Mr. Phelps, athlete, for advertisement, on the inherent presumption that Mr. Phelps is a resident.
Alternatively, if Mr. Phelps is assumed to be a non-resident, who is not a citizen of India, tax has to be deducted at source@20.8% (20% plus cess 4%) under section 194E in respect of income of ₹ 5 lakh paid to Mr. Phelps, an athlete, for advertisement referred under section 115BBA.

Question 25

Examine the liability for tax deduction at source in the following cases for the assessment year 2020-21:

(i) Wings Ltd. has paid amount of ₹ 15 lacs during the year ended 31-3-2020 to Airports Authority of India towards landing and parking charges.

(ii) Omega Ltd., an event management company, organized a concert of international artists in India. In this connection, it engaged the services of an overseas agent Mr. John from UK to bring artists to India. He contacted the artists and negotiated with them for performance in India in terms of the authority given by the company. He did not take part in event organized in India. The company made the payment of commission equivalent to ₹ 1 lac to the overseas agent.

(iii) Ramesh gave a building on sub-lease to Mac Ltd. with effect from 1-7-2019 on a rent of ₹ 20,000 per month. The company also took on hire machinery from Ramesh with effect from 1-11-2019 on hire charges of ₹ 15,000 per month. The rent of building and hire charges of machinery for the year 2019-20 were credited by the company to the account of Ramesh in its books of account on 31-3-2020.

(iv) ₹ 2,45,000 paid to Mr. X on 01-02-2020 by Karnataka State Government on compulsory acquisition of his urban land. What would be your answer if the land is agricultural land?

Answer

(i) TDS on landing and parking charges: The landing and parking charges which are fixed by the Airports Authority of India are not merely for the "use of the land". These charges are also for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport [Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)]. Thus, tax is not deductible under section 194I which provides deduction of tax for payment in the nature of rent.

Hence, tax is deductible @2% under section 194C by the airline company, Wings Ltd., on payment of ₹ 15 lacs made towards landing and parking charges to the Airports Authority of India for the previous year 2019-20.

(ii) TDS on services of overseas agent outside India: An overseas agent of an Indian company operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for contacting and negotiating with artists by Mr. John, a non-resident, who remains outside India is not subject to tax in India, consequently, there is no liability for deduction of tax at source. It is assumed that the commission equivalent to ₹ 1 lakh was remitted to Mr. John outside India.

(iii) TDS on rent for building and machinery: Tax is deductible on rent under section 194-I, if the aggregate amount of rental income paid or credited to a person exceeds ₹ 2,40,000. Rent includes payment for use of, inter alia, building and machinery. The aggregate payment made by Mac Ltd. to Ramesh towards rent in P.Y.2019-20 is ₹ 2,55,000 (i.e., ₹ 1,80,000 for building and ₹ 75,000 for machinery). Hence, Mac Ltd. has to deduct tax@10% on rent paid for building and tax@2% on rent paid for machinery.

(iv) TDS on compensation for compulsory acquisition: Tax is deductible at source @10% u/s 194LA, where payment is made to a resident as compensation or enhanced compensation on compulsory acquisition of any immovable property (other than agricultural land).

However, no tax deduction is required if the aggregate payments in a year does not exceed ₹ 2,50,000. Therefore, no tax is required to be deducted at source on payment of ₹ 2,45,000 to Mr. X, since the aggregate payment does not exceed ₹ 2,50,000.

Since the definition of immovable property specifically excludes agricultural land, no tax is deductible at source on compensation paid for compulsory acquisition of agricultural land.

Question 26

Examine whether tax has to be deducted at source under the provisions of the Income-tax Act, 1961 in the following situations, which have taken place during the year ended 31-3-2020:

(i) M/s. Jiva & Co., a partnership firm, pays a sum of ₹ 43,000 as interest on loan borrowed from an Indian branch of a foreign bank.

(ii) Above firm has paid ₹ 42,000 as interest on capital to partner Mr. A, a resident in India, and ₹ 44,000 as interest on capital to partner Mr. B, a non-resident.

(iii) The above firm paid ₹ 50,000 being share of profit of partner Mr. B, a non-resident

Answer

(i) Section 194A requires deduction of tax on any income by way of interest, other than interest on securities, credited or paid to a resident, at the rates in force.

However, it specifically excludes from its scope, income credited or paid to any banking company to which the Banking Regulation Act, 1949 applies.

An Indian branch of a foreign bank, transacting the business of banking in India, is a banking company to which the Banking Regulation Act, 1949 applies. Therefore, interest payment to such bank will not attract tax deduction under section 194A.

Consequently, no tax is required to be deducted at source under section 194A on interest of ₹ 43,000 paid by M/s. Jiva & Co., a partnership firm, on loan borrowed from an Indian branch of a foreign bank.

(ii) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities, credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner. Therefore, no tax is required to be deducted at source under section 194A on interest on capital of ₹ 42,000 paid by the firm to Mr. A, a resident partner.

Section 195, which requires tax deduction at source on payments to non-residents, does not provide for any exclusion in respect of payment of interest by a firm to its non-resident partner. Therefore, tax has to be deducted under section 195 at the rates in force in respect of interest on capital of ₹ 44,000 paid to partner Mr. B, a non-resident.

(iii) As per section 10(2A), share of profit received by a partner from the total income of the firm is exempt from tax. Therefore, the share of profit paid to non-resident partner is not liable for tax deduction at source.

However, section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax, to a non-corporate non-resident or to a foreign company, shall be required to furnish the information relating to payment of such sum in the prescribed form and manner.

Question 27

"Come Air Ltd." has paid a sum of ₹ 12 lakhs during the year ended 31-3-2020 to Airports Authority of India towards landing and parking charges. The company has deducted tax at source@2% under section 194C on the said payment and remitted the tax deducted within the prescribed time. The Assessing Officer contended that landing and parking charges were levied for use of the land of the airport and hence, the payment was in the nature of rent attracting TDS@10% under section 194-I. Discuss the correctness or otherwise of the contention of the Assessing Officer.

Answer

The issue as to whether the charges fixed by the Airport Authority of India (AAI) for landing and take-off facilities and parking facility for the aircraft are for the "use of the land" by the airline company came up before the Supreme Court in Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, the services are not restricted to merely permitting "use of the land" of airport. On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from reality.

The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the larger picture in mind, it becomes very clear that the charges are not for use of the land per se and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in Singapore Airlines case and overruled the view taken by the Delhi High Court in United Airlines/Japan Airlines case.

Applying the rationale of the Supreme Court ruling to the facts of this case, the contention of the Assessing Officer that landing and parking charges are levied for use of the land of airport and hence, the charges are in the nature of rent to attract the provisions of tax deduction at source under section 194-I is **not** correct.

Question 28

Mr. Harish, Vice President of ABC Bank, sold his house property in Chennai as well as his rural agricultural land for a consideration of ₹ 60 lakh and ₹ 15 lakh, respectively, to Mr. Suresh, a retail trader of garments, on 10.10.2019. Mr. Harish had purchased the house property and rural agricultural land in December 2017 for ₹ 40 lakh and ₹ 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 10.10.2019, is ₹ 85 lakh and ₹ 20 lakh for the house property and rural agricultural land, respectively.

(a) Determine the tax implications in the hands of Mr. Harish and Mr. Suresh, if the date of agreement for sale of house property and rural agricultural land is 1.7.2019 and the stamp duty value on the said date was ₹ 75 lakh and ₹ 15 lakh, respectively. On the said date, Mr. Suresh made payment of ₹ 5 lakh by way of account payee cheque to Mr. Harish for purchase of house property. Also, discuss the TDS implications, if any, in the hands of Mr. Suresh, assuming that both Mr. Harish and Mr. Suresh are resident Indians.

(b) Would your answer be different if Mr. Harish is a property dealer and sold the house property in the course of his business?

Answer

(a) Tax implications on sale of rural agricultural land and house property representing a capital asset in the hands of Mr. Harish, a salaried employee

(i)	**Tax implications in the hands of Mr.Harish, a salaried employee**
	Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. Harish. However, capital gains would arise on sale of house property, being a capital asset. As per section 50C(1), the stamp duty value of house property on the date of agreement (i.e., ₹ 75 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, ₹ 35 lakh (i.e., ₹ 75 lakh – ₹ 40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2020-21. It may be noted that the stamp duty value on the date of agreement can be adopted since the advance was received on the date of agreement through account payee cheque and such stamp duty value exceeds 105% of the consideration. As the date of agreement is different from the date of registration and part of the consideration was received on or before the date of agreement by way of account payee cheque, the stamp duty value on the date of agreement is to be adopted as the deemed sale consideration.
(ii)	**Tax implications in the hands of the buyer – Mr.Suresh, a retail trader**
	The house property purchased would be a capital asset in the hands of Mr. Suresh, who is a retail trader of garments. The provisions of section 56(2)(x) is attracted in the hands of Mr. Suresh who has acquired the immovable property, being a capital asset, for inadequate consideration. For the purpose of section 56(2)(x), Mr. Suresh can take the stamp duty value on the date of agreement instead of the date of registration since he has paid a part of the consideration by account payee cheque on the date of agreement. Therefore, ₹ **15 lakh,** being the difference between the stamp duty value of the property **on the date of agreement** (i.e., ₹ 75 lakh) and the actual consideration (i.e., ₹ 60 lakh) would be taxable as per section 56(2)(x) under the head "**Income from other sources**" in the hands of Mr. Suresh, since such difference exceeds the higher of ₹ 50,000 or 5% of consideration. As rural agricultural land is not a capital asset, the provisions of section 56(2)(x) are not attracted in respect of acquisition of agricultural land for inadequate consideration, since the definition of "property" under section 56(2)(x) includes only **capital assets** specified thereunder.
(iii)	**TDS implications in the hands of the buyer, Mr.Suresh**
	Since the sale consideration of house property exceeded ₹ 50 lakh, Mr. Suresh is required to deduct tax at source under section 194-IA. The tax deduction under section 194-IA would be ₹ 60,000, being 1% of ₹ 60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

Tax implications on sale of house property representing stock-in-trade in the hands of Mr. Harish, a property dealer:

(i)	**Tax implications in the hands of Mr. Harish for A.Y.2020-21**

	If Mr. Harish is a property dealer who has sold the house property in the course of his business, the provisions of section 43CA would be attracted, since the house property represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value. For the purpose of section 43CA, Mr. Harish can take the stamp duty value on the date of agreement instead of the date of registration, since he has received part of the sale consideration by an account payee cheque on the date of agreement and it exceeds 105% of consideration. Therefore, **₹ 35 lakh**, being the difference between the stamp duty value on the date of agreement (i.e., ₹ 75 lakh) and the purchase price (i.e., ₹ 40 lakh), would be chargeable as **business income** in the hands of Mr. Harish.
(ii)	**TDS implications and taxability in the hands of Mr. Suresh for A.Y.2020-21**
	There would be no difference in the TDS implications or taxability in the hands of Mr. Suresh, whether Mr. Harish is a property dealer or a salaried employee. Therefore, the provisions of section 56(2)(x) would be attracted in the hands of Mr. Suresh who has received house property, being a capital asset, for inadequate consideration. The TDS provisions under section 194-IA would also be attracted since the actual consideration for house property exceeds ₹ 50 lakh.

Question 29

Siddharth Hospitals Pvt. Ltd., has recently been accorded recognition by several insurance companies to admit and treat patients on cashless hospitalization basis. Payment to the assessee hospital will be made by Third Party Administrators (TPA) who will process the claims of the patients admitted and make payments to the various hospitals including the assessee. All TPAs are corporate entities. The assessee wants to know whether the TPAs are bound to deduct tax at source under section 194J or under section 194C?

Answer

This issue has been clarified by the CBDT Circular No.8/2009 dated 24.11.2009. As per provisions of section 194J(1), any person, who is responsible for paying to a resident any sum by way of fees for professional services, shall, at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to 10% of such sum as TDS.

Further, as per clause (a) of Explanation to section 194J "professional services" includes services rendered by a person in the course of carrying on medical profession.

The services rendered by hospitals to various patients are primarily medical services and, therefore, **the provisions of section 194J are applicable on payments made by TPAs to hospitals** etc. Further, for invoking provisions of section 194J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to hospital. Therefore, TPAs who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes including Cashless Schemes are liable to deduct tax at source under section 194J on all such payments to hospitals etc.

In view of the above, all such transactions between TPAs and hospitals would fall within the ambit of provisions of section 194J.

Question 30

Examine in the context of provisions contained in Chapter XVII of the Act and also work out the amount of tax to be deducted by the payer of income in the following cases:

(i) Payment of ₹ 5 lakh made by JCP & Co. to Pingu Events Co. Ltd. for organizing a debate competition on the subject "Preservation of Rural Heritage of Rajasthan".

(ii) "Profit Commission" of ₹ 1 lakh paid on 10.6.2019 by a re-insurance company to the insurer company after the expiry of the term of insurance and where there was no claim during the treaty.

(iii) KD, a part time director of DAF Pvt. Ltd. was paid an amount of ₹ 2,25,000 as fees which was actually in the nature of commission on sales for the period 1.4.2019 to 30.6.2019.

Answer

(i) The services of Event Managers in relation to sports activities alone have been notified by the CBDT as "professional services" for the purpose of section 194J. In this case, payment of ₹ 5 lakh was made to an event management company for organization of a debate competition. Hence, the provisions of section 194J are not attracted.

However, TDS provisions under section 194C relating to contract payments would be attracted and consequently, tax has to be deducted @ 2% under section 194C. The tax deductible under section 194C would be ₹ 10,000, being 2% of ₹ 5 lakh.

(ii) Section 194D requires deduction of tax at source@5% from insurance commission, where the commission exceeds ₹15,000.

Reinsurance is different from insurance since there is no direct contractual relationship between the person insured and the re-insurer.

In order to attract section 194D, the commission or any other payment covered under the section should be a remuneration or reward for soliciting or procuring the insurance business. The insurance companies do not procure business for the reinsurance company nor does the reinsurer pay commission or other payment for soliciting the business from the insurance companies. Therefore, section 194D has no application.

Hence, when profit commission is paid by a reinsurance company to an insurance company, after the expiry of the term of insurance, in respect of cases where there is no claim during the operation of the reinsurance treaty, tax deduction under section 194D is not attracted.

(iii) Section 194J provides for deduction of tax at source @10% on any remuneration or fees or commission, by whatever name called, paid to a director, which is not in the nature of salary in respect of which tax is deductible at source under section 192.

Hence, tax is to be deducted at source under section 194J @10% by DAF Pvt. Ltd. on the commission of ₹ 2,25,000 paid to KD, a part-time director. The tax deductible under section 194J would be ₹ 22,500, being 10% of ₹ 2,25,000.

Question 31

Examine the applicability of the provisions relating to deduction of tax at source in the following transactions:

(i) Max Limited pays ₹ 1,02,000 to Mini Limited, a resident contractor who, under the contract dated 15th October, 2019, manufactures a product according to specification of Max Limited by using materials purchased from Max Limited.

(ii) A company operating a television channel makes payment of ₹ 5 lakh to a former cricketer for making running commentary of a one-day cricket match.

(iii) EL Ltd., a foreign company, pays outside India, salary to its employee, Mr. Raghavan, a foreign national and a non-resident, for services rendered in India.

Answer

(i) The definition of "work" under section 194C includes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. In the instant case, Mini Limited manufactures the product as per the specification given by Max Limited **by using the raw materials purchased from Max Limited**. **Therefore, it falls within the definition of "work"** under section 194C. Consequently, tax is to be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. If the material component is not mentioned separately in the invoice, tax is to be deducted on the whole of the invoice value.

(ii) Provisions for deduction of tax at source under section 194J are attracted in respect of payment of fees for professional services, if the amount of such fees exceeds ₹ 30,000 in the relevant financial year. The service rendered by a commentator in relation to sports activities has been notified by the CBDT as a professional service for the purposes of section 194J vide its Notification No. 88 dated 21st August, 2008. Therefore, tax is required to be deducted@10% from the fee of ₹ 5 lacs payable to the former cricketer.

(iii) Section 195 requires deduction of tax at source by any person responsible for making payment to a non-resident, any interest or any other sum chargeable under the provisions of the Income-tax Act, 1961 (other than income chargeable under the head "Salaries").

Section 192(1) requires "any person" responsible for paying income under the head "Salaries" to deduct tax at source. Therefore, even if the payer is a foreign company, section 192 would be applicable.

TDS provisions under section 192 are attracted, if the salary payable to a non-resident is chargeable to tax in India. Under section 9(1)(ii), income which falls under the head "Salaries" shall be deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India shall be regarded as income earned in India. Therefore, salary paid to Mr. Raghavan, a non-resident, attracts tax liability in India, as he has rendered services in India and the salary is attributable to such services.

Therefore, the foreign company, EL Limited, is liable to deduct tax at source under section 192 from the salary of Mr. Raghavan.

Question 32

Examine in the following cases the obligation of the person paying the income in respect of tax deduction at source and indicate the due date for payment of such tax, wherever applicable:

(i) MNO Ltd., the employer, credited salary due for the financial year 2019-20 amounting to ₹ 3,40,000 to the account of Q, an employee, in its books of account on 31.3.2020. Q has not furnished any information about his income/loss from any other head or proof of investments/ payments qualifying for deduction under section 80C.

(ii) T, an individual whose total sales in business during the year ended 31.3.2019 was ₹ 2.20 crores, paid ₹ 9 lacs by cheque on 1.1.2020 to a contractor (an individual), for construction of his factory building. No amount was credited earlier to the account of the contractor in the books of T.

(iii) BCD Ltd. credited ₹ 28,000 towards fees for professional services and ₹ 27,000 towards fees for technical services to the account of HG in its books of account on 6.10.2019. The total sum of ₹ 55,000 was paid by cheque to HG on 18.12.2019.

Answer

(i) Section 192 requires deduction of tax from salary at the time of payment. Thus, the employer is not required to deduct tax at source when salary has not been paid but is merely credited to the account of the employee in its books of account. MNO Ltd. therefore, is not required to deduct tax at source in respect of the salary merely credited to the account of employee Q which is not paid.

If salary has been paid during the year to Q, then, MNO Ltd has to obtain from Q, the evidence/proof/particulars of prescribed claims (including claim for set-off of loss) under the provisions of the Act in such form and manner as may be prescribed.

If Q has not furnished any information about his income/loss under any other head or proof of investments/expenditure qualifying for deduction under section 80C, then, the employer has to deduct tax without considering any claim for any expenditure or set-off of losses or deduction under section 80C.

(ii) An individual who is liable for tax audit under section 44AB in the immediately preceding financial year 2018-19 is liable to deduct tax at source under section 194C for the financial year 2019-20 in respect of the payment made to contractor exceeding ₹ 30,000 in a single contract and ₹ 1,00,000 in aggregate of contracts during the financial year. Turnover of the individual T is ₹ 2.20 crores in the financial year 2018-19. Therefore, T is liable to get his accounts for that year audited under section 44AB. As the payment during financial year 2019-20 to the contractor has exceeded the limits prescribed in section 194C, tax has to be deducted under section 194C.

The rate of tax deduction is 1% as the contractor is an individual.

(iii) The limit of ₹ 30,000 for non-deduction of tax under section 194J would apply separately for fees for professional services and fees for technical services. This means that if a person has rendered services falling under both the categories, tax need not be deducted if the fee for each category does not exceed ₹ 30,000 even though the aggregate of the amounts credited to the account of such person or paid to him for both the categories of services exceed ₹ 30,000. Therefore, BCD Ltd. is not required to deduct tax at source in respect of the fees either at the time of credit or at the time of payment.

Question 33

Examine the liability for tax deduction at source in the following cases for the assessment year 2020-21:

(i) Mr. Anand has been running a sole proprietary business whose accounts are audited under section 44AB with turnover of ₹ 202 lakhs for the A.Y. 2019-20. He pays a monthly rent of ₹ 15,000 for the office premises to Mr. R, the owner of building and an individual. Besides, he also pays service charges of ₹ 6,000 per month to Mr. R towards the use of furniture, fixtures and vacant land appurtenant thereto.

(ii) By virtue of an agreement with a nationalised bank, a catering organisation receives a sum of ₹ 50,000 per month towards supply of food, water, snacks etc. during office hours to the employees of the bank.

(iii) An Indian company pays gross salary including allowances and monetary perquisites amounting to ₹ 7,30,000 to its General Manager. Besides, the company provides non-monetary perquisites to him whose value is estimated at ₹ 1,20,000.

(iv) A notified infrastructure debt fund eligible for exemption under section 10(47) of the

Income-tax Act, 1961 pays interest of ₹ 5 lakhs to a company incorporated in USA. The US Company incurred expenditure of ₹ 12,000 for earning such interest. The fund also pays interest of ₹ 3 lakhs to Mr. X, who is a resident of a notified jurisdictional area.

Answer

(i) Where the payer is an individual or HUF whose turnover exceeds the monetary limits specified in clause (a) of section 44AB, he has to deduct tax at source. Since the turnover of Mr. Anand was ₹ 202 lakhs for the A.Y.2019-20, he is liable to deduct tax at source under section 194-I in respect of rental payments during the financial year 2019-20.

Accordingly, Mr. Anand is liable to deduct tax at source under section 194-I on the rental payments made. Section 194-I provides that rent includes any payment, by whatever name called, for the use of land or building together with furniture, fittings etc. Therefore, in the given case, apart from monthly rent of ₹ 15,000 p.m., service charge of ₹ 6,000 p.m. for use of furniture and fixtures would also attract TDS under section 194-I. Since the aggregate rental payments of ₹ 2,52,000 to Mr. R during the financial year 2019-20 exceeds ₹ 2,40,000, Mr. Anand is liable to deduct tax at source @10% under section 194-I from rent paid to Mr. R.

(ii) The definition of "work" under Explanation to section 194-C includes catering services and therefore, TDS provisions under section 194C are attracted in respect of payments to a caterer. As the payment exceeds ₹ 30,000, the nationalised bank is required to deduct tax at source at 2% on the payments made to catering organisation under 194-C. If the catering organization is an individual or HUF, then the tax deduction shall be @1%.

(iii)

	₹
Gross salary, allowances and monetary perquisites	7,30,000
Non-Monetary perquisites	1,20,000
	8,50,000
Less: Standard deduction under section 16(ia)	50,000
	8,00,000
Tax Liability	75,400
Average rate of tax (₹ 75,400 / ₹ 8,00,000 × 100)	9.425%

The company can deduct ₹ 75,400 at source from the salary of the General Manager. Alternatively, the company can pay tax on non-monetary perquisites as under –

Tax on non-monetary perquisites = 9.425% of ₹ 1,20,000 = ₹ 11,310

Balance to be deducted from salary = ₹ 64,090

If the company pays tax of ₹ 11,310 on non-monetary perquisites, the same is not a deductible expenditure as per section 40(a). The amount of tax paid towards non-monetary perquisite by the employer, however, is not chargeable to tax in the hands of the employee as per section 10(10CC).

(iv) As per section 194LB, tax would be deductible @ 5% on gross interest paid/credited by a notified infrastructure debt fund, eligible for exemption under section 10(47), to a foreign company.

In the first case, since the payment is to a foreign company, health and education cess @4% has to be added to the applicable rate of TDS. Therefore, the tax deductible under section 194LB would be ₹ 26,000 (i.e., 5.20% of ₹5 lakhs).

However, in case the notified infrastructure debt fund pays interest to a person who is a

resident of a notified jurisdictional area, section 94A will apply. Accordingly, tax would be deductible @30% (plus health and education cess@4%) under section 94A, even though section 194LB provides for deduction of tax at a concessional rate of 5%. Therefore, the tax deductible in respect of payment of ₹ 3 lakh to Mr. X, who is a resident of a notified jurisdictional area, would be ₹ 93,600, being 31.2% of ₹ 3,00,000.

Question 34

The following issues arise in connection with the deduction of tax at source under Chapter XVII-Examine the liability for tax deduction in these cases:

(a) An employee of the Central Government receives arrears of salary for the earlier 3 years. He enquires whether he is liable for deduction of tax on the entire amount during the current year.

(b) A T.V. channel pays ₹ 10 lakh on 1.9.2019 as prize money to the winner of a quiz programme, "Who will be a Millionaire"?

(c) State Bank of India pays ₹ 50,000 per month as rent to the Central Government for a building in which one of its branches is situated.

(d) A television company pays ₹ 80,000 to a cameraman for shooting of a documentary film.

(e) A State Government pays ₹ 22,000 on 2.7.2019 as commission to one of its agents on sale of lottery tickets.

(f) A Turf Club awards a jack-pot of ₹ 5 lakh to the winner of one of its races on 1.2.2020.

Answer

(a) As per section 192, tax is deductible at source by any person who is responsible for paying any income chargeable under the head 'Salaries'. However, as per sub-section (2A) of that section, the employee will be entitled to relief u/s 89 and consequently he will be required to furnish to the person responsible for making the payment, such particulars in the prescribed form (i.e., Form No.10E). The person responsible for making the payment shall compute the relief and take into account the same while deducting tax at source from salary.

(b) Under section 194B, the person responsible for paying by way of winnings from any card game and other game in an amount exceeding ₹ 10,000 shall at the time of payment deduct income-tax at 30%. Therefore, tax of Rs.3 lakh has to be deducted at source from the prize money of ₹ 10 lakh payable to the winner.

(c) Section 194-I, which governs the deduction of tax at source on payment of rent, exceeding ₹ 2,40,000 p.a., is applicable to all taxable entities except individuals and HUFs, whose turnover/gross receipts do not exceed the monetary limits specified under clause (a) of section 44AB. Section 196, however, provides exemption in respect of payments made to Government from application of the provisions of tax deduction at source.

Therefore, no tax is required to be deducted at source by State Bank of India from rental payments to the Government.

(d) If the cameraman is an employee of the T.V. Company, the provisions of section 192 will apply. However, if he is a professional, TDS provisions under section 194-J will apply. Tax at 10% will have to be deducted at the time of credit of ₹ 80,000 or on its payment, whichever is earlier.

(e) Under section 194G, the person responsible for paying to any person stocking, distributing, purchasing or selling lottery tickets shall at the time of credit of the commission or payment thereof, whichever is earlier, amounting to more than ₹ 15,000, deduct income-tax at source @5%.

Accordingly, tax@5% under section 194G amounting to ₹ 1,100 has to be deducted from commission payment of ₹ 22,000 to the agent of the State Government.

(f) The payment by way of winnings from horse race is governed by section 194BB. Under this section, the person responsible for payment shall, at the time of payment, deduct tax at source @ 30%, if the payment exceeds ₹ 10,000.

Accordingly, tax@30% amounting to ₹ 1,50,000 has to be deducted from the winnings of ₹ 5 lakh payable to the winner of the race.

Question 35

Examine and compute the liability for deduction of tax at source, if any, in the cases stated hereunder, for the financial year ended 31st March, 2020

(i) Mr. X, a resident, acquired a house property at Mumbai from Mr. Y for a consideration of ₹ 90 lakhs, on 20.6.2019. On the same day, Mr. X made two separate transactions, thereby acquiring an urban plot in Kolkata from Mr. C for a sum of ₹ 49,50,000 and rural agricultural land from Mr. D for a consideration of ₹ 60 lakhs.

(ii) On 17.6.2019, a commission of ₹ 50,000 was retained by the consignee 'ABC Packaging Ltd.' and not remitted to the consignor 'XYZ Developers', while remitting the sale consideration. Examine the obligation of the consignor to deduct tax at source.

(iii) Raj is working with AB Ltd. He is entitled to a salary of ₹ 55,000 per month w.e.f. 1.4.2019. He has a house property which is self-occupied. He paid an interest of ₹ 80,000 on loan, during the previous year 2019-20. The loan was taken for construction of house. He has notified his employer AB Ltd. that there will be a loss of ₹ 80,000 in respect of this house property for financial year ended 31.3.2020.

Answer

		TDS (₹)
(i)	Since the consideration for transfer of house property at Mumbai exceeds ₹ 50 lakhs, Mr. X, being the transferee, is required to deduct tax @1% under section 194-IA on ₹ 90 lakhs, being the amount of consideration for transfer of property.	90,000
	Mr. X is not required to deduct tax as source under section 194-IA from the consideration of ₹ 49,50,000 paid to Mr. C for transfer of urban plot, since the consideration is less than ₹ 50 lakhs.	Nil
	Mr. X is also not required to deduct tax at source under section 194-IA from the consideration of ₹ 60 lakhs paid to Mr. D for transfer of rural agricultural land, since the same is specifically excluded from the scope of immovable property or the purpose of tax deduction under section 194-IA.	Nil
	Note - Section 194-IA requires every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate of 1% of such sum, at the time of credit of such sum to the account of the resident transferor or at the time of payment of such sum to the resident transferor, whichever is earlier. However, no tax is required to be deducted where the consideration for transfer of an immovable property is less than ₹ 50 lakhs.	
(ii)	Section 194H requires deduction of tax at source@5% from commission and brokerage payments to a resident. However, no tax is to be deducted at source where the amount of such payment does not exceed ₹ 15,000.	
	n the given case, 'ABC Packaging Ltd.', the consignee, has not remitted he commission of ₹ 50,000 to the consignor 'XYZ Developers' while emitting	

	the sales consideration. Since the retention of commission by the consignee/agent amounts to constructive payment of the same to him by the consignor/principal, deduction of tax at source is required to be made from the amount of commission [CBDT Circular No.619 dated 4/12/1991]. Therefore, XYZ Developers has to deduct tax at source on ₹ 50,000 at the rate of 5%.		2,500
(iii)	Section 192 provides that tax is required to be deducted on the payment made as salaries. Tax is to be deducted on the estimated income at the average of income tax computed on the basis of the rates in force for the financial year in which payment is made. The employee may declare details of his other incomes (including loss under the head "Income from house property" but not any other loss) to his employer. In this case, since Mr. Raj has notified his employer AB Ltd. of loss from self-occupied house property, the employer has to take the same into consideration for deduction of tax at source. Therefore, AB Ltd. is required to deduct tax at source on the salary of ₹ 55,000 per month paid to Mr. Raj, in the following manner:		
	Income under the head salaries (₹ 55,000 x 12)	6,60,000	
	Less: Standard deduction under section 16(ia)	50,000	
		6,10,000	
	Income under the head "house property"	(80,000)	
	Gross total income	5,30,000	
	Less: Deduction under Chapter VI-A	Nil	
	Total Income	5,30,000	
	Tax on ₹ 5,30,000	18,500	
	Add: Health and Education cess@4%	740	
	Tax to be deducted at source	19,240	19,240

Question 36

A foreign company seconded some employees to the assessee, an Indian collaborator. These employees worked with the Indian collaborator throughout the P.Y.2019-20. The employees were in receipt of salary from the Indian collaborator. They were also in receipt of special allowance directly from the foreign company in foreign currency outside India. The Indian collaborator deducted tax under section 192, on the component of salary paid by it, without taking into account the special allowance paid abroad by the foreign company in foreign currency to these employees. For this reason, the Revenue authorities treated the Indian collaborator as an 'assessee-in-default' under section 201 for non-deduction of tax at source on the "special allowance" component of salary paid by the foreign company.

Is such treatment by the Revenue Authorities and the consequent levy of interest and penalty justified?

Answer

Section 9(1)(ii) provides that any income which falls under the head "salaries" is deemed to accrue or arise in India, if it is earned in India. The Explanation thereto further clarifies that income

payable for services rendered in India shall be regarded as income earned in India.

Section 192(1) requires the person responsible for paying any income chargeable under the head "Salaries" to deduct income-tax, at the time of payment, at the average rate of income-tax computed on the basis of the rates in force for the financial year on the amount payable.

Since the TDS provisions relating to payment of income chargeable under the head "Salaries" form an integrated code along with the charging and computation provisions under the Act, section 192(1) has to be read with section 9(1)(ii) and the Explanation thereto. Therefore, if any payment under the head "Salaries" falls within section 9(1)(ii), then TDS provisions under section 192 gets attracted. Consequently, the Indian tax deductor assessee is duty bound to deduct, from the portion of salary paid by it, tax at source under section 192(1) on the entire salary paid to the employee, including special allowance paid abroad to the employee by the foreign company.

It was so held by the Apex Court in CIT, New Delhi v. Eli Lilly & Co. (India) P. Ltd. (2009) 312 ITR 225.

In this case, all the employees are resident in India, since they have worked with the Indian collaborator throughout the previous year 2019-20. If the tax due on special allowance received from the foreign company is paid by the recipient-employees, then, the Indian collaborator would not be treated as an assessee-in-default under section 201(1), if these resident-employees have furnished a return of income under section 139 on or before the due date of filing return of income, disclosing such income, and have also furnished a certificate to this effect from an accountant in the prescribed form. However, interest under section 201(1A)@1% per month or part of month shall be payable by the Indian collaborator from the date on which such tax was deductible to the date of furnishing of return by such resident employee.

In cases where the tax has not been paid by the recipient employee, the Assessing Officer can proceed under section 201(1) to recover the shortfall in payment of tax and interest thereon under section 201(1A).

However, no penalty under section 271C would be attracted, if the Indian collaborator was under the genuine and bona fide belief that it was not under any obligation to deduct tax at source from the special allowance paid by the foreign company. This is provided for under section 273B.

Section B – Additional Questions

Question 37

A sum of ₹ 60,000 was paid to Mr. Dastur, an advocate, on 1st July, 2019 towards fees for his professional services without deducting tax at source. Later on, a further sum of ₹ 70,000 was due to him on 28th February, 2020 from which tax of ₹ 13,000 was deducted at source. The tax so deducted was deposited on 25th June, 2020. Compute interest payable by the deductor under section 201(1A).

Answer

In this case, tax is deductible@10% under section 194J in respect of fees for professional services. Since there has been a delay in deduction and deposit of tax, interest under section 201(1A) is attracted.

As per the provisions of section 201(1A), if a person who is liable to deduct tax at source fails to deduct tax at source or after deducting such tax, fails to pay the tax as required by the Act, then he is liable to pay interest as follows -

(i) 1% for every month or part of month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually deducted.

(ii) 1½% for every month or part of month on the amount of such tax from the date on which such tax was deducted to the date on which tax is actually paid.

Therefore, in the given case, interest under section 201(1A) would be computed as follows –

	₹
1% on tax deductible but not deducted i.e., 1% on ₹ 6,000 for 8 months	480
1½% on tax deducted but not deposited i.e. 1½% on ₹ 13,000 for 4 months	780
Total interest payable under section 201(1A)	1,260

Question 38

Decide the following cases:

(i) Amin Co. (P) Ltd. is a dealer of motor cars manufactured by Zeet Ltd. Amin Co. (P) Ltd. paid through banking channel ₹ 110 lakhs to Zeet Ltd. for purchase of cars in January 2020. Of the total motor cars so purchased, 4 motor cars cost ₹ 11 lakhs each and 7 motor cars are for the balance amount. Decide whether any TDS / TCS provisions will apply. Will your answer be different if Amin Co. (P) Ltd. is not a dealer of motor cars and had acquired the same for the purpose of plying cars on hire?

(ii) Mr. Ramesh is employed in Raghu Ltd. as senior executive. He availed leave travel assistance (LTA) of ₹ 60,000 in January 2020. He did not produce any evidence for expenditure incurred. His salary income (computed) before allowing exemption for LTA is ₹ 12,50,000. Mr. Ramesh claimed interest on moneys borrowed for acquisition of his residential house of ₹ 96,000 but did not produce the name, address and PAN of the lender. As employer, how will you treat the claim of exemption of LTA and deduction of housing loan interest claimed by Mr. Ramesh?

Answer

(i) Section 206C(1F) requires every person, being a seller, who receives any amount as consideration for sale of a motor vehicle of the value exceeding ₹ 10 lakhs, to collect tax from the buyer@1% of the sale consideration.

However, this provision applies only in respect of transactions of retail sales and does not apply on sale of motor vehicles by manufacturers to dealers.

Therefore, Zeet Ltd. is not required to collect tax at source from Amin Co. (P) Ltd on receipt of consideration for sale of motor cars.

However, if Amin Co. (P) Ltd. is **not** a dealer of motor cars but has acquired the same for the purpose of plying cars on hire, Zeet Ltd. is required to collect tax of ₹ 44,000 [₹ 11,00,000 x 4 x 1%] at source at the time of receipt of sale consideration.

Note - Payment of ₹ 66,00,000 [₹ 1,10,00,000 (-) ₹ 44,00,000] has been made for the remaining 7 motor cars. It is assumed that equal sum of ₹ 9,42,857 [₹ 66,00,000 ÷ 7] has been paid in respect of each car. Accordingly, since the consideration for each car does not exceed ₹ 10 lakhs, no tax has to be collected at source at the time of receipt of consideration on sale of these cars.

(ii) As per Rule 26C of the Income-tax Rules, 1962, Mr. Ramesh, a salaried assessee, is required to furnish to his employer, Raghu Ltd.,

- the evidence of expenditure for claiming exemption in respect of LTA, and
- the name, address and permanent account number of the lender for claiming deduction of interest under the head "Income from house property".

If he fails to do so, Raghu Ltd. need not consider exemption in respect of LTA and loss from house property on account of provision of interest deduction, while computing tax to be deducted at source from salary income.

Accordingly, tax has to be deducted at source under section 192 on ₹ 12,50,000, being salary income (computed) without considering LTA exemption and loss from house property.

Question 39

BNG Ltd., a domestic company has deducted TDS of ₹ 28,451 during the Qtr 1 of FY 2019-20. They had filed the TDS return for Qtr 1 on 15.09.2019. The Income Tax Department had sent a notice of demand to the company, wherein a fee was levied under section 234E of the Income-tax Act, 1961 (Act) for ₹ 8,800. The Company paid the demand raised by the Department and also claimed such payment as business expenditure during the A.Y. 2020-21. Discuss whether the demand raised by the Department is correct, as per the provisions of the Act. Also, explain whether fee paid under section 234E can be claimed as deduction while computing the income under the head "Profits and gains of business or profession".

Answer

There are two issues in this case.

The first issue is about the correctness of the demand of ₹ 8,800 raised by the Department levying fee under section 234E for filing of TDS return for Quarter 1 of F.Y.2019-20 on 15.09.2019.

The second issue is whether fee paid by BNG Ltd. under section 234E can be claimed as deduction while computing income under the head "Profits and gains of business or profession".

First issue: Correctness of demand raised by the Department for fee of ₹ 8,800 u/s 234E

The statement of tax deducted at source for quarter 1 ended 30th June, 2019 has to be filed on or before 31st July, 2019.

Where a person fails to deliver or cause to be delivered the statement of tax deducted at source within the prescribed time, then, he shall be liable to pay, by way of fee, a sum of ₹ 200 for every day during which the failure continues.

The amount of fee shall not, however, exceed the amount of tax deductible.

In the present case, BNG Ltd. has filed the TDS return of Qtr 1 on 15.09.2019. Since there has been a 46 days delay on the part of BNG Ltd. in filing the statement of TDS, it would be liable to pay a fee of ₹ 9,200 (₹ 200 x 46 days) under section 234E.

Therefore, the demand of ₹ 8,800 raised by the Department is incorrect.

Second issue: Allowability of deduction in respect of fee paid under section 234E while computing income under the head "Profits and gains of business or profession"

As per section 37, any expenditure incurred wholly and exclusively for the purpose of business or profession is allowed as deduction.

This fee is not in the nature of a penalty. The fee for delayed submission of the statement of TDS is also not in the nature of interest for delayed remittance of TDS. The Legislature in its wisdom, has consciously used the word "penalty" and "interest" at other places, in contra-distinction to the word "fee". Since there is no specific prohibition in the Act for denying deduction of fee paid, hence, fee paid under section 234E is allowable as deduction while computing the business income.

Note - The normal filing fee for submission of TDS statement is an allowable deduction while computing business income and the same logic will apply to late fee as well. The late fee leviable under section 234E is similar to fee payable to the ROC for delayed filing of a statutory return under the Companies Act, 2013, which is an allowable expenditure. On similar lines, late fee leviable under section 234E is also an allowable expenditure.

Question 40

Discuss the TDSITCS implications if any, for the following transactions. What is the amount payable to the payee?:

(i) X is a bookmaker and Mr. Y is a punter. On 22-01-2020, B has won ₹ 50,000 in Horse Race 1 and suffered a loss of ₹ 20,000 in Horse Race 2.

(ii) Mr. Santosh has let out his house property on a monthly rent of ₹ 60,000 from 15·01·2020 to Mrs. Preeti.

(iii) H. Ltd., a manufacturer of luxury cars sold 50 cars on 01·09·2019 to NMP Ltd. , its dealer, each car costing ₹ 20 Lakhs.

(iv) AKL Ltd., a third party administrator on behalf of an Insurance Company has settled medical bills of ₹ 5,00,000 submitted by Kay Hospitals Ltd. from a patient under a cashless scheme.

Answer

(i) Any person, being a bookmaker, who is responsible for paying to any person any income exceeding ₹ 10,000 by way of winnings from horse races is liable to deduct tax@30% at the time of payment as per section 194BB.

In a case where the book-maker credits such winnings and debits the losses to the individual account of the punter, tax would be deducted on the winnings before set- off of losses. Thereafter, the net amount, i.e., the winnings after deduction of tax and losses, would be paid to the individual.

Thus, in the present case, Mr. X is liable to deduct tax of ₹ 15,000 (₹ 50,000 x 30%) from winnings of ₹ 50,000. The net amount payable to Mr. B would be ₹ 15,000 (i.e., ₹ 50,000 – ₹ 20,000, being loss – ₹ 15,000, being TDS).

(ii) Section 194-IB requires any individual responsible for paying to a resident any income by way of rent exceeding ₹ 50,000 per month shall deduct tax @5% of such income at the time of credit or payment of rent for the last month of the previous year, whichever is earlier.

Since Mrs. Preeti, an individual, pays rent exceeding ₹ 50,000 per month in the F.Y. 2019-20 to Mr. Santosh, she is liable to deduct tax at source @5% of such rent for F.Y. 2019-20 under section 194-IB.

Thus, ₹ 7,500 [₹ 60,000 x 5% x 2.5] has to be deducted from rent payable for March, 2020. The rent payable to Mr. Santosh for March, 2020 would be ₹ 52,500.

Note – The above answer is based on the provisions of section 194-IB, which would be

attracted in Mrs. Preeti's case.

Alternatively, in case it is assumed that Mrs. Preeti carries on business or profession and her total sales, gross receipts or turnover from the business or profession carried on by her exceeds the monetary limit specified u/s 44AB in the immediately preceding financial year, she is required to deduct tax at source @10% under section 194-I in respect of rent payable for use of any land or building, if the rent payable during the financial year exceeds ₹ 180,000. In the present case, since the rent of ₹ 1,50,000 i.e., ₹ 60,000 x 2.5 months is less than ₹ 180,000, no tax is required to be deducted at source under section 194 -I.

(iii) Every person, being a seller, who receives any amount as consideration for sale of a motor vehicle of the value exceeding ₹ 10 lakhs, shall collect tax from the buyer@1% of the sale consideration as per section 206C(1F).

However, this provision applies only in respect of transactions of retail sales and does not apply to sale of motor vehicles by manufacturers to dealers. Therefore, H Ltd., a manufacturer, is not required to collect tax at source from NMP Ltd., the dealer, on receipt of consideration for sale of motor cars.

Hence, the amount payable by NMP Ltd. to H Ltd. is ₹ 1,000 lakhs i.e., ₹ 20 lakhs x 50.

(iv) Every person, who is responsible for paying to a resident any sum by way of fees for professional services exceeding ₹ 30,000 shall deduct tax at source at the rate of 10% at the time of credit to the account of the payee or at the time of payment, whichever is earlier, as per section 194J.
"Professional services" include services rendered by a person in the course of carrying on medical profession.

The CBDT has, vide Circular No.8/2009 dated 24.11.2009, clarified that since the services rendered by hospitals to various patients are primarily medical services, TPAs (Third Party Administrator's), who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes including cashless schemes are liable to deduct tax at source on all such payments to hospitals etc.

Thus, AKL Ltd., a TPA is liable to deduct tax of ₹ 50,000, being 10% of ₹ 5,00,000 from the payment made to Kay Hospitals Ltd. Hence, the amount payable by AKL Ltd. to Kay Hospitals Ltd. would be ₹ 4,50,000 [₹ 5,00,000 – ₹50,000]

Question 41

Examine the applicability of provisions relating to deduction/collection of tax at source and compute the liability, if any, for deduction/collection of tax at source in the following cases for financial year ended 31st March, 2020 as per provisions contained under the Income-tax Act, 1961:-

(i) In terms of agreement between A (the Owner of land) and B (Developer and Builder) the Developer, B agrees to allot 5 apartments to the owner in part consideration for providing his land and also agreed to pay a sum of ₹ 25,00,000. In terms of the agreement, Mr. B issued a cheque for ₹ 15,00,000 towards part of consideration on 30.03.2020.

(ii) (1) Rent of ₹ 60,000 per month deposited by Mr. Shrikanth, software employee on 1st of every month in advance, in the account of Mr. Ashok, who does not provide his PAN. The house was taken on rent with effect from 01.07.2019 and he vacated the house on 28.02.2020.

(2) Would there be any change in TDS, if Mr. Ashok furnished his PAN to the tenant?

(iii) ₹ 19,50,000 credited to the account of Digitec Studios (a partnership firm) on 31.03.2020 by B-TV, Television channel, towards part consideration for shooting of Tele Episode for 10 weeks as per the storyline, contents and specifications of B-TV channel.

Answer

(i) Since the agreement between the owner of land, A, and the developer and builder, B, is in the nature of specified agreement under section 45(5A), which involves cash consideration as well, TDS@10% on ₹25,00,000, being the cash component payable to A, is deductible under section 194-IC. Assuming that only ₹15,00,000, being the amount paid to A on 30.3.2020, has actually been credited to the account of Ain the books of B in the P.Y.2019-20, the TDS liability would be ₹1,50,000, being 10% of ₹15,00,000.

Note – If it is assumed that ₹ 25,00,000 has been credited to the account of A in the books of B in the P.Y.2019-20, even though only ₹ 15,00,000 has been actually paid in that year, then, tax has to be deducted@10% on ₹ 25,00,000, being the amount credited to the account of A. TDS liability would be ₹ 2,50,000, being 10% of ₹ 25,00,000.

(ii) (1) Since Mr. Shrikanth pays rent exceeding ₹ 50,000 per month in the F.Y. 2019-20, he is liable to deduct tax at source @5% under section 194-IB on such rent for F.Y. 2019-20.

However, since Mr. Ashok does not provide his PAN to Mr. Shrikanth, tax would be deductible@20%, instead of 5%**.**

Tax has to be deducted from rent payable for the last month of the P.Y.2019-20. However, since he vacated the premises in February, 2020, tax has to be deducted from rent paid on 1.2.2020 for the month of February, 2020.
Tax of ₹ 96,000 [₹ 60,000 x 20% x 8] has to be deducted but the same has to be restricted to ₹ 60,000**,** being rent for February, 2020.

(2) If Mr. Ashok furnished his PAN to Shrikanth, tax would be deductible@5%**.**

Tax of ₹ 24,000 [₹ 60,000 x 5% x 8] has to be deducted from rent paid on 1 2.2020 for the month of February, 2020.

(iii) Shooting of Tele Episode for B-TV as per the storyline, contents and specifications of B-TV falls within the scope of "work" under section 194C. Since the amount credited exceeds the specified limit of ₹ 30,000, TDS@2% under section 194C is attracted on ₹ 19,50,000 credited to the account of Digitec Studios, a partnership firm.

TDS liability would be ₹ 39,000 [being 2% of ₹19,50,000]

Question 42

Discuss whether liability to deduct tax at source arises in the under-mentioned (independent) situations in respect of following payments made by residents in India:

(i) Dindayal & Co., a partnership firm, has credited a sum of ₹ 67,000 and ₹ 4,000 respectively, as interest to partners L (Resident in India) and M (non-resident) respectively.

(ii) Payment of ₹ 5 lakhs made by Shiv & Company (partnership firm) to Jyoti & Company Ltd. for organising debate competition on the subject 'Rural Heritage of Rajasthan'.

Answer

(i) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner.

Section 195 which requires tax deduction at source on payment to non-residents, does not provide for any exclusion in respect of payment of interest by firm to its non-resident partner.

Therefore, Dindayal & Co., a partnership firm is not required to deduct tax at source u/s 194A on the amount of interest of ₹ 67,000 credited to the account of L, resident in India.

Tax at source under section 195 @ 31.2% [30%, being the rate in force + cess@4%] in respect of interest of ₹ 4,000 credited to the account of M, a non-resident is required to be deducted.

(ii) The services of event managers in relation to sports activities alone have been notified by the CBDT as "professional services" for the purpose of section 194J. In this case, payment of ₹ 5 lacs was made to Jyoti & Company Ltd., an event management company for organization of a debate competition. Hence, the provisions of section 194J are not attracted in this case.

However, TDS provisions under section 194C relating to contract payments would be attracted and consequently, tax has to be deducted @2% under section 194C.

Question 43

Discuss the liability of TDS provisions in the following independent cases:

(i) X Ltd. is a producer of natural gas. During the year, it sold natural gas worth ₹ 20,50,000 to M/s Hawa Co., a partnership firm. It also incurred ₹ 2,00,000 as freight for the transportation of gas. It raised the invoice and clearly bifurcated the value of gas as well as the transportation charges.

(ii) Beta Ltd, gave a contract to Alpha Ltd. for the supply of 2000 pens on which the logo of Beta Ltd. was printed. The raw materials were purchased by Alpha Ltd. from C Ltd., which is not related to Beta Ltd. The consideration paid for the pens was ₹ 1,50,000.

(iii) M/s. Taba Ltd. enters into a contract with Mr. Babu for the transportation of its products from its plant to warehouses. It pays a lump-sum amount of ₹ 2,50,000 to Mr. Babu for the year at the year end. Mr. Babu is engaged in the business of plying goods carriages on hire. Mr. Babu is not an assessee under Income-tax Act and thus did not provide PAN to Taba Ltd.

(iv) M/s. Sunivesh Investors is engaged in the business of stock broking, depositories, mobilisation of deposits and marketing of public issues. It is a registered member of Bombay Stock Exchange. Every year it makes payment amounting to ₹ 10 lakhs, to the Stock Exchange by way of transaction charges in respect of fully automated online trading facility. This service is available to all members of the stock exchange in respect of every transaction that is entered into. Would it be liable for tax deduction under section 194J?

Answer

(i) TDS u/s 194C is attracted on any sum payable to a resident contractor for carrying out any work. Since X Ltd., the producer of natural gas sells as well as transports the gas to the purchaser, M/s. Hawa Co., a partnership firm, till the point of delivery, where the ownership of gas is simultaneously transferred, the manner of raising the sale bill (whether the transportation charges are embedded in the cost of gas or shown separately) does not alter the basic nature of such contract which remains essentially a 'contract for sale' and not a 'works contract' as envisaged in section 194C.

Therefore, in such circumstances, TDS provisions under section 194C are not applicable on the component of Gas Transportation Charges payable by M/s. Hawa Co. to X Ltd. Consequently, there is no liability to deduct tax at source under section 194C in this case.

(ii) TDS u/s 194C is attracted on any sum payable to a resident contractor for carrying out any work. However, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer, as such a contract is a 'contract for sale'.

In this case, since Alpha Ltd. has to supply pens to Beta Ltd. by using materials purchased from C Ltd., the contract for supply of pens is a 'contract for sale' and not a works contract. Consequently, there is no liability to deduct tax at source under section 194C in this case.

(iii) Tax is not required to be deducted at source under section 194C from the sum credited or paid to the account of a contractor, during the course of the business of plying, hiring or leasing goods carriages, if he furnishes his PAN to the deductor.

In this case, since Mr. Babu has not furnished his PAN to M/s. Taba Ltd., M/s. Taba Ltd. has to deduct tax at source@20% as per section 206AA on lumpsum payment of ₹ 2,50,000 to Mr. Babu, since the same exceeds the aggregate threshold of ₹ 1,00,000.

(iv) Under section 194J, TDS is attracted in respect of, inter alia, fees for technical services. Technical services like managerial and consultancy services are in the nature of specialised services made available by the service provider to cater to the special needs of the customer-user as may be felt necessary. It is the above feature that distinguishes or identifies a service provider from a facility offered

However, the service provided by the BSE for which transaction charges are paid does not satisfy the test of specialized, exclusive and individual requirement of the user or the consumer who may approach the service provider for such assistance or service. Therefore, the transaction charges paid to BSE by its members are not for technical services but are in the nature of payments made for facilities provided by the stock exchange. Such payments would, therefore, not attract the provisions of tax deduction at source under section 194J.

Accordingly, payment of transaction charges of ₹ 10 lakhs by M/s. Sunivesh Investors to BSE in respect of fully automated online trading facility would not be liable for tax deduction at source under section 194J.

Question 44

M/s A Ltd. had admitted ₹ 180 lakhs as its total income in its return filed for the Assessment Year 2017-18 on 15-9-2017. The total income was enhanced to ₹ 200 lakhs as per the order under section 143(3) passed on 20-9-2019 by the Assessing Officer. Subsequently on an information that there was concealment of income, reassessment proceedings were initiated and an order for reassessment was passed on 20 -10-2020 determining a total income of ₹ 250 lakhs.

The Company had the following prepaid taxes to its credit:

Tax deducted at source ₹ 5 lakhs

Advance Tax paid on

4-6-2016 ₹ 8 lakhs

14-9-2016 ₹ 17 lakhs

14-12-2016 ₹ 16 lakhs

15-3-2017 ₹ 14 lakhs

Self-Assessment tax paid on 15-9-2017 ₹ 2.50 lakhs

Tax paid on 25-9-2019 ₹ 7 lakhs

The return in response to the reassessment notice was filed after 20 days from the due date mentioned in the notice. Assume the tax rate to be 33.063%.
Determine interest payable by the Company under various sections of the Income-tax Act on account of reassessment. Give necessary explanations for your answer.

Answer

Interest under section 234A

Since the return of income in response to notice for reassessment is furnished by M/s A Ltd. after the expiry of the time allowed under such notice, interest under section 234A will be payable for 1 month, being 20 days delay in filing return of income, @1% on the amount by which the tax on ₹ 250 lakhs**,** being the total income determined on reassessment exceeds the tax on ₹ 200 lakhs, being total income determined u/s 143(3).

Particulars	₹
Tax on total income determined on reassessment [₹250 lakhs x 33.063%]	82,65,750
Less: Tax on total income determined u/s 143(3) [₹200 lakhs x 33.063%]	66,12,600
	16,53,150
Interest u/s 234A = ₹16,53,000 x 1% x 1 = ₹ 16,530	

Interest under section 234B

As a result of reassessment, M/s A. Ltd is required to pay minimum ₹ 69.89175 lakhs as advance tax, being 90% of assessed tax of ₹ 77.6575 lakhs [₹ 82.6575 (33.063% of ₹ 250 lakhs) – ₹ 5 lakhs (TDS)] and it has paid only ₹ 55 lakhs. Since, there is a shortfall of payment of advance tax, interest under section 234B will be payable for 43 months, being from 1.4.2017 to 20.10.2020, @1% on the amount by which the tax on ₹ 250 lakhs, being the total income determined on reassessment exceeds the tax on ₹ 200 lakhs, being total income determined u/s 143(3).

Interest u/s 234B = ₹16,53,000 x 1% x 43 = ₹ 7,10,790

Interest under section 234C

Particulars	₹
Tax on total income (₹ 200 lakhs x 33.063%)	66,12,600
Less: Tax deducted at source	5,00,000
Tax due on returned income/Total advance tax payable as per order u/s 143(3)	61,12,600
Particulars	**₹**
Tax on total income (₹ 250 lakhs x 33.063%)	82,65,750
Less: Tax deducted at source	5,00,000
Tax due on returned income/Total advance tax payable as per reassessment order	**77,65,750**

Calculation of interest payable under section 234C:

Date (a)	Advance tax paid till date (₹) (b)	Advance tax payable as per order u/s 143(3) on which interest u/s 234C has levied (c) (₹)	Minimum % of tax due on returned income as per reassessment order to be paid till date to avoid interest under section 234C (d)		Advance tax payable till date in case condition mentioned in (c) is not met (e)	Short-fall [(e) - (b) for installment 1 & 2] and (e) – (c) for installment 3 & 4	Interest
			%	Amount (₹)		(₹)	(₹)
15.06.2016	8,00,000	7,33,512	12%	9,31,890	11,64,863 [15%]	3,64,863	3,64,800 x 1% x 3 months = **10,944**
15.09.2016	25,00,000	22,00,536	36%	27,95,670	34,94,588 [45%]	9,94,588	9,94,500 x 1% x 3 months = **29,835**
15.12.2016	41,00,000	45,84,450	75%	58,24,313	58,24,313 [75%]	12,39,863	12,39,800 x 1% x 3 months **= 37,194**
15.03.2017	55,00,000	61,12,600	100%	77,65,750	77,65,750 [100%]	16,53,150	16,53,100 x 1% **=16,531**
Interest payable under section 234C (10,944 + 29,835 + 37,194 + 16,531)							**94,504**

Question 45

Gamma (P) Ltd., an Indian company established in the year 2007, reports total income of ₹ 22 lakh for the previous year ended 31st March, 2020. Tax deducted at source by different payers amounted to ₹ 1,68,000 and tax paid in Country A on a doubly taxed income amounted to ₹ 30,000 for which the company is entitled to relief under section 90 as per the double taxation avoidance agreement.

During the year, the company paid advance tax as under:

Date of payment	Advance tax paid (₹)
13-06-2019	45,000
14-09-2019	90,000
13-12-2019	1,00,000
14-03-2020	1,05,000

The company filed its return of income for the A.Y. 2020-21 on 3rd November, 2020.

Compute interest, if any, payable by the company under sections 234A, 234B and 234C and fee payable under section 234F. Assume that transfer pricing provisions are not applicable and that the company has not opted for the provisions of section 115BAA.

Note – Turnover of Gamma (P) Ltd. for P.Y. 2017-18 is ₹ 251 crore.

Answer

Interest under section 234A: Since the return of income has been furnished by Gamma (P) Ltd. on 3rd November, 2020 i.e., after the due date for filing return of income (30.9.2020), interest under section 234A will be payable for 2 months @ 1% p.m. on the amount of tax payable on the total income, as reduced by tax reliefs and prepaid taxes.

Particulars	₹
Tax on total income (₹ 22,00,000 x 26%) [Since turnover of P.Y. 2017- 18 does not exceed ₹ 400 crore, the rate of tax would be 26% (i.e., 25% + HEC@4%)]	5,72,000
Less: Advance tax paid	3,40,000
Less: Tax deducted at source	1,68,000
Less: Relief of tax allowed under section 90	30,000
Tax payable on self-assessment	**34,000**
Interest under section 234A = ₹ 34,000 x 1% x 2 months= ₹ 680	

Interest under section 234B: Where the advance tax paid by the assessee is less than 90% of the assessed tax, the assessee would be liable to pay interest under section 234B.

Computation of assessed tax	₹
Tax on total income (₹ 22,00,000 x 26%)	5,72,000
Less: Tax deducted at source	1,68,000
Less: Relief of tax allowed under section 90	30,000
Assessed tax	**3,74,000**
90% of assessed tax = ₹ 3,74,000 x 90% = ₹ 3,36,600	

Since the advance tax paid by Gamma (P) Ltd. (₹ 3,40,000) is more than ₹ 3,36,600, being 90% of the assessed tax (₹ 3,74,000), it is not liable to pay interest under section 234B.

Interest under section 234C

Particulars	₹
Tax on total income (₹ 22,00,000 x 26%)	5,72,000
Less: Tax deducted at source	1,68,000
Less: Relief of tax allowed under section 90	30,000
Tax due on returned income/Total advance tax payable	**3,74,000**

Calculation of interest payable under section 234C:

Due Date for payment of advance tax	Advance tax paid till date (₹)	Advance tax payable till date %	Minimum % of tax due on returned income to be paid till date to avoid interest u/s 234C		Shortfall	Interest
			%	Amt (₹)	(₹)	(₹)
15.6.2019	45,000	15%	12%	44,880	-	Nil **(See Note below)**
15.9.2019	1,35,000	45%	36%	1,34,640	-	Nil **(See Note below)**
15.12.2019	2,35,000	75%	75%	2,80,500	45,500	45,500 x 1% x 3 months = 1,365
15.3.2020	3,40,000	100%	100%	3,74,000	34,000	34,000 x 1% = 340
Interest payable under section 234C (Nil + Nil + ₹ 1,365 + ₹ 340)						**₹ 1,705**

Note: Since the advance tax paid by Gamma (P) Ltd. on 13th June, 2019 is more than 12% of the tax due on returned income (i.e., ₹ 3,74,000) and the advance tax paid on 14th September, 2019 is more than 36% of the tax due on returned income, it is not liable to pay any interest under section 234C in respect of these two quarters.

Fee under section 234F

₹ 5,000 is payable under section 234F by way of fee, since the return was filed aft er the due date but before 31.12.2020.

CHAPTER - 16
Income Tax Authorities

Section A – ICAI Study Material Questions

Question 1

Rajesh regularly files his return of income electronically. While he was trying to upload his return of income for assessment year 2019-20 on 31st August, 2019 (extended due date), last date for filing the same, he found it extremely difficult to do the same due to network problems and ultimately he became successful in making e-filing of his return only at 1 a.m. on 1st September, 2019. The return contained a claim for carry forward of business loss of ₹ 51 lakh. This circumstance was recorded in a letter delivered to the office of the Deputy Commissioner of Income Tax on 1st September, 2019 during normal office hours. Rajesh made a request to the CBDT for condonation of delay in filing the return of income.

Discuss whether the CBDT has the power to condone the delay in filing the return of income and permit carry forward of loss in the given circumstance.

Would your answer change, if the return contained a claim for carry forward of business loss of ₹ 48 lakh.

Answer

Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or **any other relief under the Act** after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of late filing of a return is relatable to a claim arising under the category of "any other relief available under the Act". Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.

The facts of the case are similar to the case of Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441, where the Delhi High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown justifiable reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the assessee. Therefore, the Court held that the delay of one day in filing of the return had to be condoned.

Further, the CBDT Circular No. 9/2015 dated 09.06.2015 has expressly clarified that CBDT can consider application for such claim where the amount exceeds ₹ 50 lakhs.

Applying the rationale of the above court ruling and the clarification given in CBDT Circular to the case on hand, the CBDT has the power to condone the delay in filing the return of income of Mr. Rajesh and permit carry forward of business loss of ₹ 51 lakhs, since the delay of one hour was due to a genuine and justifiable reason i.e., network problem while e-filing the return.

However, if the claim for carry forward of business loss is 48 lakhs, then, the Principal Chief Commissioner of Income-tax/Chief Commissioner of Income-tax has the power to condone the delay (since the amount is between 10 lakhs to 50 lakhs). It may be noted that if the claim is less than ₹10 lakhs, the Principal Commissioner/Commissioner of Income-tax is empowered to condone the delay. This clarification is given in CBDT Circular No. 9/2015 dated 09.06.2015.

Question 2

Examine the correctness of the statement "the jurisdiction of an Assessing Officer cannot be objected by the assessee".

Answer

According to section 124(3), the assessee can raise a question as to the jurisdiction of an Assessing Officer within the prescribed time limit as under:

(i) **where a return has been filed** under section 139(1) then, within one month from the date of service of notice under section 142(1) or section 143(2) or before the completion of assessment, whichever is earlier.

(ii) **where no return has been filed,** then, within the expiry of time allowed by the notice under section 142(1) or section 148 for filing the return or within the time allowed in show cause notice issued seeking as to why a best judgment assessment under section 144 should not be made, whichever is earlier.

(iii) where search is initiated under section 132 or books of accounts, other documents or any assets are requisitioned under section 132A, within one month from the date on which he was served with a notice under section 153A(1) or 153C(2) or before the completion of assessment, whichever is earlier.

Where the assessee calls in question the jurisdiction of an Assessing Officer and the Assessing Officer is not satisfied with such claim, he shall refer the matter for determination by the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner before the assessment is made.

Therefore, in view of the above provisions, the statement that "the jurisdiction of an Assessing Officer cannot be objected by the assessee" is not correct.

Question 3

The Director General of Income Tax after getting the information that Mr. Mogambo is in possession of unaccounted cash of ₹ 50 lacs, issued orders by invoking powers vested in him as per section 131(1A), for its seizure. Is the order for seizure of cash issued by the Director General of Income Tax correct? If not, does the Director General of Income Tax have any other power to seize such cash?

Answer

The powers under section 131(1A) deal with power of discovery and production of evidence. They do not confer the power of seizure of cash or any asset. The Director General, for the purposes of making an enquiry or investigation relating to any income concealed or likely to be concealed by any person or class of persons within his jurisdiction, shall be competent to exercise powers conferred under section 131(1), which confine to discovery and inspection, enforcing attendance, compelling the production of books of account and other documents and issuing commissions. Thus, the power of seizure of unaccounted cash is not one of the powers conferred on the Director General under section 131(1A).

However, under section 132(1), the Director General has the power to authorize any Additional Director or Additional Commissioner or Joint Director or Joint Commissioner etc. to seize money found as a result of search [Clause (iii) of section 132(1)], if he has reason to believe that any person is in possession of any money which represents wholly or partly income which has not been disclosed [Clause (c) of section 132(1)]. Therefore, the proper course open to the Director General is to exercise his power under section 132(1) and authorize the Officers concerned to enter the premises where the cash is kept by Mr. Mogambo and seize such unaccounted cash.

Question 4

The premises of Ganesh were subjected to a search under section 132 of the Act. The search was authorized and the warrant was signed by the Joint Commissioner of Income-tax having jurisdiction over the assessee, consequent to information in his possession. The assessee challenged the validity of search on the ground that section 132(1) does not empower Joint Commissioner to authorise a search under the Act. Decide the correctness of the contention raised by the assessee.

Answer

Under section 132(1), the income-tax authorities listed therein are empowered to authorise other income-tax authorities to conduct search and seizure operations. The authorities empowered to issue authorization include such Additional Director, Additional Commissioner, Joint Director and Joint Commissioner as are empowered by the CBDT to do so.

However, a Joint Commissioner can issue warrant of authorization only if he has been specifically empowered to do so by the CBDT. Therefore, only if the Joint Commissioner has not been specifically empowered by the CBDT to do so, the contention of the assessee would hold good.

Question 5

Examine whether the information regarding possession of unexplained assets and income received from the Central Bureau of Investigation, a Government agency, can constitute "information" for action under section 132. Discuss.

Answer

As per section 132(1)(c), authorization for search and seizure can take place if the authority, in consequence of information in his possession, has reason to believe that any person is in possession of money, bullion, jewellery or other valuable article or thing and these assets represent, either wholly or partly, income or property which has not been, or would not be disclosed by such person for the purposes of this Act. In the absence of such information, a search cannot be validly authorized.

The Apex Court in UOl v Ajit Jain [2003] 260 ITR 80 has held that mere intimation by the CBI that money was found in the possession of the assessee, which according to the CBI was undisclosed, without something more, does not constitute "information" within the meaning of section 132, on the basis of which a search warrant could be issued. Consequently, the Supreme Court held that the search conducted on this basis and the assessment made pursuant to such search was not valid.

Question 6

In the course of search operations under section 132 in the month of July, 2019, a tax payer makes a declaration under section 132(4) on the earning of income not disclosed in respect of P.Y.2018-19. Can that statement save the tax payer from a levy of penalty, if he is yet to file his return of income for A.Y.2019-20?

Answer

Since the search is conducted on or after 15.12.2016, and return is yet to be filed for the P.Y. 2018-19, the penalty would be as follows

(1) penalty@30%, if undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income

was derived, pays the tax, together with interest if any, in respect of the undisclosed income, and furnishes the return of income for the specified previous year declaring such undisclosed income on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be).

(2) penalty@60% in any other case.

Therefore, even if the tax payer furnishes the statement under section 132(4), penalty@30% of undisclosed income of the specified previous year would be attracted under section 271AAB.

Question 7

Cash of ₹ 25 lacs was seized on 12.9.2019 in a search conducted as per section 132 of the Act. The assessee moved an application on 27.10.2019 to release such cash after explaining the sources thereof, which was turned down by the department. The assessee seeks your opinion on, the following issues:

(i) Can the department withhold the explained money?

(ii) If yes, then to what extent and upto what period?

Answer

The proviso to section 132B(1)(i) provides that where the person concerned makes an application to the Assessing Officer, within 30 days from the end of the month in which the asset was seized, for release of the asset and the nature and source of acquisition of the asset is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, 1961, etc. out of such asset. 'Existing liability', however, does not include advance tax payable. Such asset or portion thereof has to be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

In this case, since the application was made to the Assessing Officer within the 30 day period the amount of existing liability may be recovered out of the asset and the balance may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

Note: It may be noted that one of the conditions mentioned above for release of an asset is that the nature and source of acquisition of the asset should be explained to the satisfaction of the Assessing Officer. However, in this case, it has been given that the assessee's application for release of the asset, explaining the sources thereof, was turned down by the Department. If the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset, then, the asset (in this case, cash) cannot be released, since the condition mentioned above is not satisfied.

Question 8

The business premises of Ram Bharose Ltd. and the residence of two of its directors at Delhi were searched under section 132 by the DDI, Delhi. The search was concluded on 9.8.2019 and following were also seized besides other papers and records:

(i) Papers found in the drawer of an accountant relating to Shri Krishna Ltd., Mumbai indicating details of various business transactions. However, Ram Bharose Ltd. is not having any direct or indirect connection of any nature with these transactions and Shri Krishna Ltd., Mumbai and its directors.

(ii) Jewellery worth ₹ 5 lacs from the bed room of one of the director, which was claimed by him to be of his married daughter.

(iii) Papers recording certain transactions of income and expenses having direct nexus with the business of the company for the period from 16.4.2015 to date of search. It was admitted by the director that the transactions recorded in such papers have not been incorporated in the books.

You are required to answer on the basis of aforesaid and the provisions of Act, following questions:

(a) What action the DDI shall be taking in respect of the seized papers relating to Shri Krishna Ltd., Mumbai?

(b) Whether the contention raised by the director as to jewellery found from his bed-room will be acceptable?

(c) What presumption shall be drawn in respect of the papers which indicate transactions not recorded in the books?

(d) Can the company move an application for settlement of case as per Chapter XIX-A of the Act?

Answer

(a) The authorised officer being DDI, Delhi is not having any jurisdiction over Shri Krishna Ltd., Mumbai, and therefore as per section 132(9A), the papers seized relating to this company shall be handed over by him to the Assessing Officer having jurisdiction over Shri Krishna Ltd., Mumbai within a period of 60 days from the date on which the last of the authorisations for search was executed for taking further necessary action thereon.

(b) The contention raised by the Director will not be acceptable because as per the provisions of sub-section (4A)(i) of section 132, where any books of account, other documents, money, bullion, jewellery or other valuables are found in the possession or control of any person in the course of search, then, in respect thereof, it may be presumed that the same belongs to that person.

(c) As per section 132(4A), the presumptions in respect of the papers, indicating transactions not recorded in the books but having direct nexus with the business of the company, are that the same belong to the company, contents of such papers are true and the handwriting in which the same are written is/are of the persons(s) whose premises have been searched.

(d) As per clause (iiia) in the Explanation to section 245A, the assessee can approach the Settlement Commission at any time after the date of issue of notice under section 153A or section 153C initiating the assessment proceedings. Therefore, an application can be made to the Settlement Commission where search has been initiated under section 132 followed by assessment under section 153A or section 153C.

The proviso to section 245C(1) specifies the monetary limit for making application for settlement of cases, in respect of search cases. Accordingly, the additional amount of income-tax payable on the income disclosed in the application must exceed ₹ 50 lacs so that application for settlement of the case is eligible for admission.

Question 9

In the course of search on 25.03.2020, assets were seized. Examine the procedure laid down to deal with such seized assets under the Act.

Answer

Section 132B of the Income-tax Act, 1961 deals with the application of assets seized under section 132. Such assets will be first applied towards the existing liability under the Income-tax Act, 1961, etc. 'Existing liability', however, does not include advance tax payable. Further, the amount of liability determined on completion of search assessment (including any penalty levied or interest payable in connection with such assessment) and in respect of which the assessee is in default or deemed to be in default, may be recovered out of such assets.

Where the nature and source of acquisition of such seized assets is explained to the satisfaction of the Assessing Officer, the amount of any existing liability mentioned in para 1 above may be recovered out of such asset and the remaining portion, if any, of the asset may be released, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, as the case may be. The release must be made within 120 days from the date on which the last of the authorisations for search under section 132 or for requisition under section 132A was executed. The assets would be released to the person from whose custody they were seized.

When the assets consist of solely of money, or partly of money and partly of other assets, the Assessing Officer may apply such money in the discharge of the liabilities referred to in para 1 above and the assessee shall be discharged of such liability to the extent of the money so applied. However, the assets other than money may also be applied for the discharge of such liabilities if the complete recovery could not be made from the money seized or the money seized was not sufficient.

Section B – Additional Questions

Question 10

The Assessing Officer within his jurisdiction surveyed a popular Cyber Café at 12 o'clock in night for the purpose of collecting information which may be useful for the purposes of the Income-tax Act, 1961. The Cyber Café is kept open for business every day between 2 p.m. and 2 a.m. The owner of the Cyber Café claims that the Assessing Officer could not enter the café in late night. The Assessing Officer wanted to take away with him the books of account kept at the Cyber Café. Examine the validity of the claim made by owner and the proposed action of the Assessing Officer.

Answer

The Assessing Officer can exercise his power of survey under section 133A only after obtaining the approval of the Joint Commissioner or Joint Director, as the case may be. Assuming that he has obtained such approval in this case, he is empowered under section 133A to enter any place of business of the assessee within his jurisdiction only during the hours at which such place is open for the conduct of business.

In the case given, the cyber cafe is open from 2.00 p.m. to 2.00 a.m. for the conduct of business. The Assessing Officer entered the cyber cafe at 12 o'clock in the night which falls within the working hours of the cyber cafe. Therefore, the claim made by the owner to the effect that the Assessing Officer could not enter the cyber cafe at late night is not in accordance with law.

Further, as per section 133A(3)(ia), the Assessing Officer may, impound and retain in his custody for such period as he thinks fit, any books of account or other documents inspected by him. However, he shall not impound any books of account or other documents except after recording his reasons for doing so. He shall not retain in his custody any such books of account or other documents for a period exceeding fifteen days (exclusive of holidays) without obtaining the approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Commissioner or Commissioner or Principal Director or Director therefor, as the case may be.

Question 11

An Assessing Officer entered a hotel run by a person, in respect of whom he exercises jurisdiction, at 8 p.m. for the purpose of collecting information, which may be useful for the purposes of the Act. The hotel is kept open for business every day between 9 a.m. and 9 p.m. The hotelier claims that the Assessing Officer could not enter the hotel after sunset.

The Assessing Officer wants to take away with him the books of account kept at the hotel.

Examine the validity of the claim made by the hotelier and the proposed action of the Assessing Officer with reference to the provisions of section 133B of the Income-tax Act, 1961.

Answer

Section 133B(2) of the Income-tax Act, 1961 empowers an income-tax authority to enter any place of business during the hours at which such place is open for the conduct of business. The hotel is open from 9.00 a.m. to 9.00 p.m. for the conduct of business. The Assessing Officer entered the hotel at 8.00 p.m. which falls within the working hours. The claim made by the hotelier to the effect that the Assessing Officer could not enter the hotel after sunset is not in accordance with law.

Section 133B(3) provides that an income tax authority acting under this section shall, on no account, remove or cause to be removed from the place wherein he has entered, any books of account. In view of this clear prohibition in section 133B(3), the proposed action of the Assessing Officer to take away with him the books of account kept at the hotel is not valid in law.

CHAPTER - 17
Assessment Procedure

Section A – ICAI Study Material Questions

Question 1

Teachwell Education is a trust approved under section 10(23C)(vi) which runs various educational institutions. During the course of assessment under section 143(3), the Assessing Officer finds that the trust has carried out its activities in contravention of the section under which it was approved for exemption. Hence, the Assessing Officer wants to pass an order without giving exemption under section 10, which the assessee objects. You are required to examine the following with respect to the provisions of Income-tax Act, 1961.

(a) Whether the Assessing Officer can pass order without giving exemption under section 10?
(b) Can the Assessing Officer get any additional time limit in completing this assessment?

Answer

(a) As per the first proviso to section 143(3), in the case of an institution approved under, inter alia, section 10(23C)(vi), which is required to furnish the return of income under section 139(4C), the Assessing Officer shall not pass an order of assessment under section 143(3) without giving effect to the provisions of section 10, unless he is of the view that the activities of the institution are being carried on in contravention to the provisions of that section and:

(1) he has intimated the Central Government or the prescribed authority, which had earlier approved the concerned institution, about the contravention of the relevant provisions by the institution; and
(2) the approval granted to such institution has been withdrawn or notification in that respect has been rescinded.

Therefore, in the aforesaid case, the Assessing Officer can pass an assessment order without giving exemption under section 10 to Teachwell Education, which is an educational institution approved under section 10(23C)(vi), only if he has intimated the contravention made by Teachwell Education to the Central Government or the prescribed authority, as the case may be, and its approval under section 10(23C)(vi) is withdrawn.

(b) As per Explanation 1 to section 153, in case the Assessing Officer intimates the contravention of provisions of section 10(23C)(vi) to the Central Government or the prescribed authority, the period commencing from the date of intimation of such contravention by the Assessing Officer and ending on the date on which the copy of the order of withdrawing the approval under section 10(23C)(vi) is received by the Assessing Officer, shall be excluded for computing the period of limitation for completing the assessment.

Further, in case the time limit available to the Assessing Officer for passing an assessment order, after such exclusion, is less than 60 days, such remaining period of assessment shall be deemed to have been extended to 60 days.
Therefore, the Assessing Officer will get the above mentioned additional time for completing the assessment of Teachwell Education.

Question 2

State with reasons whether return of income is to be filed in the following cases for the Assessment Year 2020-21:

(i) Mr. X, a resident individual, aged 80 years, has a total income of ₹ 2,85,000. He has claimed deduction of ₹ 1,50,000 under section 80C. Long-term capital gains of ₹ 80,000 is not taxable by virtue of the exemption available upto specified threshold under section 112A.

Would your answer change if Mr. X has incurred ₹ 1,05,000 towards payment of electricity bills for F.Y.2019-20?

(ii) ABC, a partnership firm, has a loss of ₹ 10,000 during the previous year 2019-20.

(iii) A registered association, eligible for exemption under section 10(23B), has income from house property of ₹ 2,60,000.

(iv) Mr. Y, aged 45 years, an employee of ABC (P) Ltd, draws a salary of ₹ 4,90,000 and has income from fixed deposits with bank of ₹ 10,000.

Answer

S. No.	Is filing of return required?	Reason
(i)	No	As per the provisions of section 139(1), every person, whose total income without giving effect to the provisions of Chapter VI-A exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. X before giving effect to deduction of ₹ 1,50,000 under section 80C is ₹ 4,35,000, which is less than the basic exemption limit of ₹ 5,00,000 applicable to an individual aged 80 years or more. Therefore, Mr. X need not furnish his return of income for the A.Y. 2020-21. **Note** – Yes, the answer would change, since Mr. X has incurred expenditure of an amount exceeding ₹ 1 lakh towards consumption of electricity. Hence, he would have to file his return for A.Y.2020-21 on or before the due date u/s 139(1).
(ii)	Yes	As per section 139(1), it is mandatory for a firm to furnish its return of income or loss on or before the specified due date. Therefore, M/s ABC has to furnish its return of loss for the A.Y. 2020-21 on or before the due date under section 139(1), even if it has incurred a loss.
(iii)	Yes	As per section 139(4C), every institution referred to, inter alia, in section 10(23B), whose total income without giving effect to the provisions of section 10 exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date under section 139(2). In the above case, the registered association has income from house property of ₹ 2,60,000 before exemption under section 10, which exceeds the basic exemption limit of ₹ 2,50,000. Therefore, it is under an obligation to furnish its return of income for the A.Y. 2020-21.
(iv)	Yes	As per the provisions of section 139(1), every person, whose gross total income exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. Mr. Y's salary income is ₹ 4,40,000 (i.e., ₹ 4,90,000 less standard deduction of ₹ 50,000). The gross total income of Mr. Y is ₹ 4,50,000 (₹ 4,40,000 + ₹ 10,000) which exceeds the basic exemption limit of ₹2,50,000 applicable to an individual. Therefore, Mr. Y has to furnish his return of income for the A.Y. 2020-21.

Question 3

The Assessing Officer issued a notice under section 142(1) on the assessee on 24th December, 2019 calling upon him to file return of income for Assessment Year 2019-20. In response to the said notice, the assessee furnished a return of loss and claimed carry forward of business loss and unabsorbed depreciation. State whether the assessee would be entitled to carry forward as claimed in the return.

Answer

As per the provisions of section 139(3), any person who has sustained loss under the head 'Profit and gains of business or profession' is allowed to carry forward such a loss under section 72(1) or section 73(2), only if he has filed the return of loss within the time allowed under section 139(1). Also, the provisions of section 80 specify that a loss which has not been determined as per the return filed under section 139(3) shall not be allowed to be carried forward and set-off under, inter alia, section 72(1) (relating to business loss) or section 73(2) (losses in speculation business) or section 74(1) (loss under the head "Capital gains") or section 74A(3) (loss from the activity or owning and maintaining race horses) or section 73A (loss relating to a "specified business"). However, there is no such condition for carry forward of unabsorbed depreciation under section 32.

In the given case, the assessee has filed its return of loss in response to notice under section 142(1). As per the provisions stated above, the return filed by the assessee in response to notice under section 142(1) is a belated return and therefore, the benefit of carry forward of business loss under section 72(1) or section 73(2) or section 73A shall not be available. The assessee shall, however be entitled to carry forward the unabsorbed depreciation as per provisions of section 32(2).

Question 4

The regular assessment of MNO Ltd. for the Assessment Year 2018-19 was completed under section 143(3) on 13th March, 2020. There was an audit objection by the Revenue Audit team that interest on loan should be disallowed partly as there was diversion of borrowed fund to sister concern without charge of interest.

Based on the above facts:

(i) State, with reasons, whether the Assessing Officer can issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

(ii) If the action stated in (i) above is not permitted, what is the option open to the Revenue Department to deal with the said audit objection?

Answer

(i) Section 147 states that if the Assessing Officer has **reason to believe that any income chargeable to tax has escaped assessment for any assessment year**, he may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section.

The Assessing Officer should, therefore, have reason to believe that income chargeable to tax has escaped assessment. The belief should be that of the Assessing Officer and not of the revenue audit team.

Further, the Income-tax Act, 1961 does not confer jurisdiction on the Assessing Officer to change its opinion on the interpretation of a particular provision earlier adopted by it. If the issue had already been considered earlier during the course of scrutiny assessment and the Assessing Officer had come to a conclusion that no disallowance of interest paid by the assessee is required, even though loans had been given to sister concern without any interest, the same issue cannot be the basis of reassessment, merely because the revenue audit team takes a different view.

The Supreme Court, in ACIT v. ICICI Securities Primary Dealership Ltd. (2012) 348 ITR 299, held that re-opening of the assessment by the Assessing Officer on the ground of change of opinion is not valid.

Therefore, the Assessing Officer cannot issue notice under section 148 solely on the basis of audit objection of the Revenue Audit team.

If the Assessing Officer has acted only under compulsion of the audit party and not independently, the action of reopening would be invalid.

(ii) The option open to the Revenue is initiation of proceedings under 263, by the jurisdictional Commissioner. He has the power to call for and examine the records, if he is of the opinion that the order passed by the Assessing Officer under section 143(3) is erroneous in so far as it is prejudicial to the interests of the Revenue.

However, where the Assessing Officer has considered the issue in the original assessment and come to a conclusion that no disallowance of interest is called for, the Commissioner cannot initiate revisionary proceedings, merely because he holds a different view. Only where the view taken by the Assessing Officer is unsustainable in law, the Commissioner will be justified in initiating the revisionary proceedings under section 263. It was so held in CIT vs. Sohana Woollen Mills (2008) 296 ITR 238 (P & H).

Mere audit objection and possibility of a different view are not sufficient to conclude that the order of the Assessing Officer is erroneous or prejudicial to the interest of revenue.

Question 5

State whether the following assessees have to file return of income and if so, the due date for the assessment year 2020-21:

(i) A registered trade union having income from let out property of ₹ 1,00,000.

(ii) A public trust hospital having an aggregate annual receipt of ₹ 205 lacs and availing exemption of ₹ 2,20,000 under section 10(23C)(via) with total income of ₹ 1,10,000.

Answer

(i) A registered trade union is having income from house property, which is exempt under section 10(24).

Section 139(4C) mandates filing of return only when the total income exceeds the maximum amount which is not chargeable to tax without giving effect to the provisions of section 10. In this case, even without giving effect to section 10(24), the total income of the registered trade union is below basic exemption limit and therefore, there is no mandatory requirement to file the return of income.

(ii) Since the total income without giving effect to the exemption u/s 10(23C)(via) is ₹ 3,30,000, which exceeds ₹ 2,50,000, the trust has to file its return of income by 30th September, 2020.

Question 6

Dishant received a notice under section 148 from the Assessing Officer for A.Y. 2016-17 on the ground that depreciation on certain assets was allowed in excess. The Assessing Officer recorded the reason for reopening. The original assessment was completed under section 143(3). In course of reassessment proceeding, the Assessing Officer also disallowed certain sum under section 14A in respect of expenses purported to be in relation to dividend from companies and tax-free interest. However, the Assessing Officer did not record the reason for applying the provisions of

section 147 in respect of the issue of disallowance under section 14A and passed the order disallowing the excess depreciation and also certain sum under section 14A. Dishant contended that the Assessing Officer can make disallowance under section 14A, since the same was not the reason for reopening the assessment. Discuss the correctness of Dishant's contention.

Answer

Explanation 3 to section 147 permits the Assessing Officer to assess or reassess the income in respect of any issue (which has escaped assessment) which comes to his notice subsequently in the course of proceedings under section 147, even though the reason for such issue does not form part of the reasons recorded under section 148(2).
Therefore, in the instant case, the Assessing Officer has the power to disallow expenses under section 14A in addition to disallowing excess depreciation for which notice under section 148 was issued even though the reason for issue relating to disallowance under section 14A was not recorded under section 148(2).
Hence, the contention of Dishant is not correct.

Question 7

In the proceedings initiated under section 153A, the assessment order passed in respect of Mr. Simbu pertaining to a particular assessment year was annulled by the Income-tax Appellate Tribunal in its order passed on 28.1.2020. The same was received on 28.2.2020 by the jurisdictional Commissioner of Income-tax. Does the Department have any power to complete the assessment subsequent to such annulment? If yes, within what time limit?

Answer

As per section 153A(2), if any proceedings initiated under section 153A or any order of assessment or reassessment made u/s 153A(1) has been annulled in any appeal or other legal proceeding, the abated assessment or reassessment relating to any assessment year shall stand revived with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner. If the order of annulment is set aside, such revival shall cease to have effect.

The time limit for completion of such assessment or reassessment shall be one year from the end of the month in which the abated assessment revives or within the period specified in section 153B(1) [i.e., 21 months[4] from the end of the financial year in which the last of authorisations for search or requisition was executed], whichever is later.

Question 8

What will be the consequences when Mr. Raghav made payment of ₹ 75,000 in cash to a travel agent for his travel to Saudi Arabia to be undertaken for business purposes by quoting intentionally the wrong PAN? Would your answer be different if such cash payment was made for his travel to Nepal, instead of Saudi Arabia?

Answer

If a person who is required to quote his permanent account number in any document referred to in section 139A(5)(c), quotes a number which is false, and which he either knows or believes to be false or does not believe to be true, the Assessing Officer may direct that such a person shall pay by way of penalty a sum of ₹ 10,000 under section 272B(2).

In the given case, if Mr. Raghav travels to Saudi Arabia and pays his travel agent cash in excess of ₹ 50,000, such a transaction is covered by section 139A(5)(c) read with Rule 114B and therefore, Mr. Raghav has to quote his PAN. Since Mr. Raghav has misquoted his PAN, penalty under section

272B(2) is leviable. Mr. Raghav has to be given an opportunity of being heard in the matter. If Mr. Raghav is not able to prove that there was a reasonable cause for the said failure, penalty under section 272B(2) would be imposable.

The answer would remain the same even if such cash payment was made for his travel to Nepal.

Question 9

For facilitating expeditious resolution of disputes relating to international transactions involving transfer pricing and foreign companies, the Income-tax Act, 1961, has provided for "alternate dispute resolution mechanism". In this context, you are required to answer the following:

(i) What meanings have been assigned to "dispute resolution panel" and the "eligible assessee" under this mechanism?

(ii) When can a grievance for resolution be filed by an assessee?

(iii) What evidences are being considered by the panel to redress the grievance of the assessee?

Answer

(i) The term "Dispute Resolution Panel" has been defined to mean a collegium comprising of three Principal Commissioners or Commissioners of Income-tax constituted by the Board for this purpose.

The term "Eligible Assessee" means any person in whose case the variation referred to in section 144C(1) in the income or loss returned arises as a consequence of the order of the Transfer Pricing Officer passed under section 92CA(3) and any foreign company.

(ii) The Assessing Officer shall forward a draft of the proposed order of assessment to the eligible assessee and on receipt of such order, the eligible assessee shall, within thirty days of the receipt of the draft order, file his acceptance of the variations to the Assessing Officer or file his objections, if any, to such variation, with the Dispute Resolution Panel and the Assessing Officer.

(iii) The Dispute Resolution Panel shall, in a case where any objections are received, take into consideration:-

(a) the draft order

(b) the objections filed by the assessee

(c) the evidence furnished by the assessee

(d) the report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority

(e) the records relating to the draft order

(f) the evidence collected by, or caused to be collected by it

(g) the result of any enquiry made by or caused to the made by it,

and issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

Question 10

The Assessing Officer has the power to make an assessment to the best of his judgment, in certain situations. What are they?

Answer

Under section 144, the Assessing Officer, after taking into account all relevant material which he has gathered, is under an obligation to make an assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee in the following cases –

(1) Where any person fails to make the return under section 139(1) and has not filed a belated return under section 139(4) or a revised return under section 139(5).

(2) Where any person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited.

(3) Where any person, having made a return, fails to comply with all the terms of a notice issued under section 143(2).

Further, section 145(3) of the Income-tax Act, 1961 permits the Assessing Officer to make an assessment in the manner provided in section 144:

(i) where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee; or

(ii) where the method of accounting under section 145(1) has not been regularly followed by the assessee;

(iii) where the income has not been computed in accordance with "Income Computation and Disclosure Standards" notified by the Central Government under section 145(2).

Question 11

The assessment of CNK Associates, a partnership firm, for the assessment year 2017-18 was made under section 143(3) on 31st July, 2019. The Assessing Officer made two additions to the income of the assessee viz. (a) addition of ₹ 2 lacs under section 40(a)(ia) due to non-furnishing of evidence of payment of TDS and (ii) addition of ₹ 5 lacs on account of unexplained cash credit. The assessee contested addition on account of unexplained cash credit in appeal to the Commissioner (Appeals). The appeal was decided in January, 2020 against the assessee. The assessee approaches you for your suggestion as to whether it should apply for revision to the Commissioner under section 264 or rectification to the Assessing Officer under section 154 as regards disallowance under section 40(a)(ia). What should be your suggestion?

Answer

The Commissioner cannot exercise his power of revision under section 264 where the order sought to be revised has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal [Section 264(4)], even if the relief claimed in the revision is different from the relief claimed in the appeal. This was the view of the Supreme Court in the case of Hindustan Aeronautics Limited vs. CIT (2000) 243 ITR 808. It is not open to the assessee to seek recourse to revision under section 264 after the appeal is decided. Therefore, although the matter of addition of ₹ 2 lacs under section 40(a)(ia) was not taken before the Commissioner (Appeals), the assessee,
CNK Associates cannot apply for revision under section 264 in respect of the same.

Under section 154(1A), where any matter had been considered and decided in any proceeding by way of appeal or revision, rectification of such matter cannot be done by the Assessing Officer. However, in respect of the matter which has not been considered and decided in the appeal or revision, the order of the Assessing Officer can be rectified under section 154. Thus, the assessee can apply to the Assessing Officer for rectification of the order in respect of addition under section 40(a)(ia), as this matter has not been considered and decided in any proceeding by way of appeal or revision.
In view of above, the assessee, CNK Associates should seek rectification under section 154.

Question 12

Examine critically in the context of provisions of the Act "Can the Assessing Officer issue notice under section 148 to reopen the same assessment order on the same grounds for which the CIT had issued notice under section 263 of the Act"?

Answer

The Assessing Officer cannot issue notice under section 148 to reopen the same assessment order on the same grounds for which the Commissioner had issued notice under section 263 of the Income-tax Act, 1961, since the third proviso to section 147 specifically provides that the Assessing Officer may assess or reassess an income which is chargeable to tax and has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, if the income relates to a matter which is the subject matter of revision under section 263, then the Assessing Officer cannot issue notice under section 148 to reopen the assessment order.

Question 13

Is the Assessing Officer empowered to assess or reassess an income which is chargeable to tax and has escaped assessment, in a case which is pending before the Appellate Tribunal? Discuss.

Answer

As per third proviso to section 147, the Assessing Officer may assess or reassess an income which is chargeable to tax and which has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, in respect of the matters which are the subject matter of an appeal before the Appellate Tribunal, it is not possible for the Assessing Officer to initiate proceeding under section 147. However, in respect of other matters, which are not the subject matter of the appeal, the Assessing Officer can initiate proceeding under section 147.

Question 14

A search was conducted under section 132 in the business premises of Harish on 15th December, 2019. At that time, assessments under section 143(3) for A.Y. 2017-18 and A.Y. 2018-19 and reassessment proceeding under section 147 for A.Y. 2016-17 were pending before the Assessing Officer.

(i) What are the assessment years for which notice can be issued for making post-search assessment?

(ii) What would be the fate of pending assessments and reassessment?

(iii) What would be the effect, if the post-search assessment orders are annulled by the Income-tax Appellate Tribunal?

Answer

(i) The notice under section 153A can be issued for six assessment years preceding the assessment year relevant to the previous year in which the search is conducted. In this case, the search is conducted in the previous year 2019-20, the relevant assessment year for which is A.Y.2020-21. Therefore, notice can be issued for the six preceding assessment years i.e. for assessment years 2014-15 to 2019-20.

Further, notice for assessment or reassessment can be issued by Assessing Officer for the relevant assessment year or years (i.e. for A.Y.2010-11 to A.Y.2013-14) if the following conditions are satisfied:

(a) The Assessing Officer has in his possession, books of account or other documents or evidence which reveal that the income, represented in the form of asset, which has escaped assessment amounts to or is likely to amount ₹ 50 lakhs or more in the relevant assessment year or in aggregate in the relevant assessment years.

(b) The income so referred above has escaped assessment for such year or years; and

(c) The search under section 132 is initiated or requisition under section 132A is made on or after 01.04.2017 (This condition is satisfied since the search has taken place in December, 2019).

Note - The expression "relevant assessment year" shall mean an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls beyond six assessment years but not later than ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted or requisition is made.

"Asset" shall include immovable property being land or building or both, shares and securities, loans and advances, deposits in bank account.

(ii) As per section 153A, the assessment or reassessment relating to any assessment year, falling within the above period of six assessment years and for the relevant assessment year or years, pending on the date of initiation of the search under section 132, shall abate. In other words, they will cease to be applicable. Therefore, the assessments under section 143(3) for assessment years 2017-18 and 2018-19 and the reassessment proceeding under section 147 for assessment year 2016-17 **shall abate.**

(iii) Section 153A provides that where the post-search assessment order is annulled in any appeal or any other legal proceeding, the abated assessment and reassessment proceedings shall stand revived. Therefore, the assessments under section 143(3) relating to assessment years 2017-18 and 2018-19 and the reassessment proceeding relating to assessment year 2016-17, which abated on initiation of search, **shall stand revived** with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner.

Question 15

A search was conducted under section 132 in the business premises of Sanskar on 5th March, 2019. The search was concluded by executing last of authorisation for search on 21st March, 2019. Since the search is concluded in the financial year 2018-19, and other conditions are also fulfilled, the Assessing Officer issued notice under section 153A on Sanskar for preceding ten Assessment Years prior to the Assessment Year relevant to the previous year 2018-19. Thus, he issued the notice from A.Y. 2009-10 to A.Y.2018-19. Discuss the correctness of the action taken by Assessing Officer.

Answer

As per section 153A, the Assessing Officer can issue the notice to file a return in respect of six assessment years and for the relevant assessment year or years immediately preceding the assessment year relevant to the previous year in which the search was conducted under section 132 or requisition was made under section 132A.

However, no notice for assessment or reassessment shall be issued by Assessing Officer for the relevant assessment year or years unless:

(a) He has, in his possession, books of account or other documents or evidence which reveal that the income, represented in the form of assets, which has escaped assessment amounts to or is likely to amount ₹ 50 lakhs or more in the relevant assessment year or in aggregate in the relevant assessment years.

(b) The income so referred above has escaped assessment for such year or years.

(c) The search under section 132 is initiated or requisition under section 132A is made on or after 01.04.2017

The expression "relevant assessment year" shall mean an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls beyond six assessment years but not later than ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted or requisition is made.

Thus, it is clear that the Assessing Officer can issue the notice in respect of four assessment years which falls beyond six assessment years, subject to fulfillment of aforesaid conditions. As per condition (c) above, search must be initiated on or after 01.04.2017.

In the given case, Assessing Officer has initiated the search on 5.03.2019 and concluded on 21.03.2019. Therefore, the condition given in (c) is satisfied. Assuming that conditions given in (a) and (b) are also satisfied, the Assessing Officer could issue the notice for ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted. i.e. from A.Y.2013-14 to A.Y. 2018-19 as well as the relevant assessment years, namely, A.Y. 2009-10 to A.Y. 2012-13

Hence, the action of Assessing Officer in issuing the notice under section 153A for A.Y.2009-10 to A.Y.2018-19, is correct.

Question 16

Examine whether the Assessing Officer has the power to make any adjustment to income disclosed by the assessee in the return of income in course of processing the return under section 143(1)?

Answer

The procedure to be followed for summary assessment is contained in section 143(1). As per section 143(1), the total income or loss of an assessee shall be computed after making the following adjustments to the returned income:

(i) any arithmetical error in the return; or

(ii) an incorrect claim, if such incorrect claim is apparent from any information in the return.

(iii) disallowance of loss claimed, if return is filed beyond due date u/s 139(1)

(iv) disallowance of expenditure indicated in the audit report but not taken into account in computing the total income in the return

(v) disallowance of deduction claimed under section u/s 10AA, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID or 80-IE, if return is filed beyond due date u/s 139(1)

No such adjustment shall be made unless as intimation is given to the assessee of such adjustment either in writing or electronic mode. Further, Assessing Officer shall make any adjustment after considering the response received from the assessee, if any. Where no response is received with 30 days of the issue of such notice, the above adjustment can be made.

For the purpose of section 143(1), “an incorrect claim apparent from any information in the return” means such claim on the basis of an entry, in the return of income:

(i) of an item, which is inconsistent with another entry of the same or some other item in such return;

(ii) in respect of which, the information required to be furnished under the Income-tax Act, 1961 to substantiate such entry, has not been so furnished;

(iii) in respect of a deduction, where such deduction exceeds specified statutory limit which may be expressed as monetary amount or percentage or ratio or fraction.

Question 17

Can the Assessing Officer complete the assessment of income from international transactions in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee?

Answer

Section 92CA(4) provides that the order of the Transfer Pricing Officer determining the arm's length price of an international transaction is binding on the Assessing Officer and the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer and on the basis of contention raised by the assessee.

Question 18

Tai Ltd. filed its return of income for assessment year 2019-20 on 26th September, 2019. The return is selected for regular assessment under section 143(3) for which notice under section 143(2) is served on the company on 3rd October, 2020. The company responded to the notice under section 143(2). Examine whether the service of the notice is within time and if not, whether the assessment order can be challenged by the assessee.

Answer

The time limit for service of notice under section 143(2) is six months from the end of the financial year in which the return of income was furnished by the assessee. The return of income for assessment year 2019-20 was filed by the assessee on 26th September, 2019. Therefore, the notice under section 143(2) has to be served by 30th September, 2020. However, the notice was served on the assessee only on 3rd October, 2020. Hence, the notice issued under section 143(2) is time- barred.

However, as per section 292BB, where an assessee had appeared in any proceedings or co- operated in any enquiry relating to an assessment or reassessment, it shall be deemed that any notice required to be served upon him, has been duly served upon him in time in accordance with the provisions of the Act and such assessee shall be precluded from raising any objection in any proceeding or enquiry that the notice was (a) not served upon him or (b) not served upon him in time or (c) served upon him in an improper manner.

The above provision shall not be applicable where the assessee has raised such objection before the completion of such assessment or reassessment. Therefore, in the instant case, if the assessee, Tai Limited, had raised an objection to the proceeding, on the ground of non-service of the notice under section 143(2) upon it on time, then, the validity of the assessment order can be challenged. In absence of such objection, the assessment order cannot be challenged.

Question 19

In the case of Mr. Rajesh, a summary assessment was made under section 143(1) for assessment year 2016-17 without calling him. Thereafter, Mr. Rajesh has received a notice under section 148 on 6th April, 2019 for reopening of assessment. Can Mr. Rajesh challenge the legality of the notice on the ground of change of opinion?

Answer

Under the scheme of section 143(1), only the adjustments relating to any arithmetical error in the return, incorrect claim which is apparent from any information in the return, disallowance of loss

claimed where return of income for set-off of loss is claimed was filed beyond the due date under section 139(1), disallowance of expenditure indicated in the audit report but not taken into account in computing total income in the return and disallowance of deduction claimed under section 10AA, sections 80-IA to 80-IE, where return is furnished beyond due date. In short, what is permissible is only correction of errors apparent on the basis of the of the return and tax audit report filed. Therefore, the intimation given under section 143(1) is only a preliminary assessment, commonly referred to as a summary assessment without calling the assessee. The same cannot be treated as an order of assessment under section 143(3). Since there has been no assessment under section 143(3) in this case, the question of change of opinion does not arise.

Therefore, the assessee cannot challenge the legality of the notice issued under section 148 reopening the assessment on the ground of change of opinion in a case where no assessment is made under section 143(3). This inference is supported by the Supreme Court ruling in ACIT vs. Rajesh Jhaveri Stock Brokers P. Ltd. (2007) 291 ITR 500.

Question 20

Discuss the correctness or otherwise of the following proposition in the context of the Income-tax Act, 1961:

A fresh claim before the Assessing Officer can be made only by filing a revised return and not otherwise.

Answer

This proposition is correct. A return of income filed within the due date under section 139(1) or a belated return filed under section 139(4) may be revised by filing a revised return under section 139(5) where the assessee finds any omission or wrong statement in the original return subject to satisfying other conditions. There is no provision in the Income-tax Act, 1961, to make changes or modification in the return of income by filing a letter before the Assessing Officer. The revised return can be filed at any time before the end of the relevant assessment year or before completion of assessment, whichever is earlier. In a case where a return of income has been filed within the due date under section 139(1) or a belated return is filed under section 139(4), the only option available to the assessee to make an amendment to such return is by way of filing a revised return under section 139(5). Therefore, a fresh claim can be made before the Assessing Officer only by filing a revised return and not otherwise. The Supreme Court, in Goetze (India) Ltd. vs. CIT (2006) 284 ITR 323, has held that there is no provision in the Income-tax Act, 1961 to allow an amendment in the return of income filed except by way of filing a revised return.

Question 21

The Assessing Officer within the powers vested in him under section 142(2A), while examining the accounts of PNF Ltd., had ordered to get the same audited. The company challenges this order on the ground "that the opportunity was not provided to them by the Assessing Officer prior to passing of such an order". Decide the correctness of the action of the Assessing Officer.

Answer

As per the proviso to section 142(2A), the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.

Therefore, in this case, the order of the Assessing Officer is not valid, since the assessee was not given an opportunity of being heard prior to passing of such order.

Question 22

Smt. Kanti engaged in the business of growing, curing, roasting and grounding of coffee after mixing chicory had a total income of ₹ 6,00,000 from this business which was her only source of income during the year ended on 31.3.2020. She consults you to have an opinion whether she is required to file return of income for the A.Y. 2020-21 as per provisions of section 139(1).

Would your answer change if she had travelled to USA during the P.Y.2019-20 and incurred ₹ 2.20 lakhs for the same?

Answer

The clarification regarding filing of return of income by the coffee growers being individuals covered by Rule 7B of the Income-tax Rules, 1962 is given in Circular No.10/2006 dated 16.10.2006. According to the Circular, an individual deriving income from growing, curing, roasting and grounding of coffee with or without mixing chicory, would not be required to file the return of income if the aggregate of 40% of his or her income from growing, curing, roasting and grounding of coffee with or without mixing chicory and income from all other sources liable to tax in accordance with the provisions of this Act, is equal to or less than the basic exemption limit prescribed in the First Schedule of the Finance Act of the relevant year.

In this case, Smt. Kanti has a total income of ₹ 6,00,000 from this business, which was her only source of income for P.Y.2018-19. 40% of her total income works out to ₹2,40,000, which is less than the basic exemption limit of ₹2,50,000 in respect of an individual assessee. Therefore, Smt. Kanti is not required to file a return of income for the A.Y.2020-21 as per the provisions of section 139(1).

If Smt. Kanti had travelled to USA during the P.Y.2019-20 and incurred ₹2.20 lakhs on such travel, she would be required to mandatorily file a return of income for A.Y.2020-21 on or before the due date u/s 139(1), even though her total income does not exceed the basic exemption limit.

Question 23

Ram, an individual, filed his return of income for the assessment year 2020-21 on 15.6.2020. He later discovered that he had not claimed deduction under section 80C in the said return. He claimed the said deduction through a letter addressed to the Assessing Officer. The Assessing Officer completed the assessment without allowing the deduction claimed by Ram. Is the Assessing Officer justified in doing so?

Answer

The Supreme Court has, in Goetze (India) Ltd. v. CIT (2006) 284 ITR 323, ruled that the assessing authority has no power to entertain a claim for deduction made after filing of the return of income otherwise than by way of a revised return. In the instant case, Ram has claimed the deduction under section 80C, which he omitted to claim in the original return of income, through a letter addressed to the Assessing Officer and not by filing a revised return under section 139(5). In view of the decision of the Supreme Court cited above, the Assessing Officer was justified in completing the assessment without allowing the deduction under section 80C.

Question 24

Examine the correctness or otherwise of the following statements in the context of provisions contained in the Income-tax Act, 1961 and the decided case laws:

"The Assessing Officer is bound to allow the set-off of brought forward losses under section 72 even if the assessee has not claimed the same in the return filed".

Answer

The statement is correct.

The Supreme Court has, in CIT v. Mahalakshmi Sugar Mills Co. Ltd. (1986) 160 ITR 920, held that it is the duty of the Assessing Officer to apply the relevant provisions of the Act for the purpose of determining the true figure of the assessee's total income and consequential tax liability. Merely because the assessee has not claimed the set-off in the return filed, it cannot relieve the Assessing Officer of his duty to apply section 72 in the appropriate case.

As per CBDT Circular No.14 (XL-35) of 1955 dated 11.04.1955, it is the duty of the Assessing Officer to assist a taxpayer in every reasonable way, particularly in the matter of claiming and securing reliefs and in this regard, they should take the initiative in guiding a taxpayer where proceedings or other particulars before them indicate that some refund or relief is due to him.

Therefore, on the basis of the above Supreme Court ruling and the CBDT Circular, the Assessing Officer is bound to allow the set-off of brought forward losses under section 72, even if the assessee has not claimed the same in the return filed, provided the loss was determined in pursuance of a return filed under section 139(3) in any earlier previous year.

Moreover, the wording used in section 72 is "shall", indicating that the provisions relating to set off of brought forward business loss are mandatory.

Therefore, the Assessing Officer is bound to allow the claim for set off of brought forward business losses even if the assessee has not claimed the same in the return filed.

Question 25

X, an individual, has got his books of account for the year ending 31.3.2020 audited under section 44AB. His total income for the assessment year 2020-21 is ₹ 5,20,000. He desires to know if he can furnish his return of income for the assessment year 2020-21 through a Tax Return Preparer.

Answer

Section 139B provides for submission of return of income through Tax Return Preparers. It empowers the Central Board of Direct Taxes (CBDT) to frame a scheme for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income through Tax Return Preparers. Specified class or classes of persons have been defined to mean any person, other than a company or a person whose accounts are required to be audited under section 44AB or under any other existing law, who is required to furnish a return of income under the Act. Thus, companies and persons whose accounts are liable for tax audit under section 44AB do not fall within the definition of 'specified class or classes of persons' and consequently, cannot furnish their returns of income through Tax Return Preparers. In the instant case, the books of account of X for the year ending 31.3.2020 have been audited under section 44AB. As such, he cannot furnish his return of income for the assessment year 2020-21 through a Tax Return Preparer.

Question 26

In April, 2019, the business premises of Priyanka Ravi were searched under section 132 by the DDI, Delhi. The search was concluded on 30.04.2019 and following assets/documents were found which were not recorded in her books of accounts:

- Jewellery of ₹ 25 Lacs pertaining to P.Y. 2014-15
- Agreement for purchase of land which contains the payment of advance of ₹ 35 Lacs in cash in the P.Y.2013-14
- Shares purchased in the P.Y.2011-12 and in the P.Y.2012-13 totaling to ₹ 40 Lacs.
- Paper containing the payment of ₹ 15 Lacs in the P.Y.2009-10 and ₹ 10 Lacs in P.Y.2008-09 to a contractor for construction of residential house.

Accordingly, Assessing Officer has issued the notice for all the previous years from P.Y.2008-09 to P.Y.2018-19 under section 153A.

However, Miss Priyanka Ravi contented that the Assessing Officer cannot issue the notice under

section 153A beyond six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted under section 132 i.e. notice can be issued upto A.Y.2014-15 (P.Y. 2013-14).
Discuss about the correctness of action of Assessing Officer and the contention of Miss Priyanka Ravi.

Answer

As per section 153A(1), issuance of notice and assessment or reassessment under the said section can also be made for an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls **beyond six assessment years** but **not beyond ten assessment years** from the assessment year relevant to the previous year in which search is conducted or requisition is made, provided that -

(i) the Assessing Officer has in his possession books of account or other documents or evidence which reveal that the income which has escaped assessment amounts to or is likely to amount to **fifty lakh rupees or more in one year or in aggregate in the relevant assessmentyears;**

(ii) such income escaping assessment is represented in the form of asset which **shall include immovable property being land or building or both, shares and securities, deposits in bank account, loans and advances;**

(iii) the income escaping assessment or part thereof relates to such year or years; and

(iv) search under section 132 is initiated or requisition under section 132A is made on or after 1-4-2017.

In the light of the above amended provision, the Assessing Officer can issue the notice u/s 153A beyond six assessment years but not beyond ten assessment years from the assessment year relevant to the previous year in which search is conducted or requisition is made. Thus, in the given case, the Assessing Officer can issue notice under section 153A upto A.Y.2010-11 as she,

a. has in his possession, documents or evidence which reveals the escaped assessment amounts to ₹ 55 lacs in aggregate during the relevant four assessment years i.e. from A.Y. 2010-11 to A.Y. 2013-14

b. such income escaping assessment represents in the form of assets which includes ₹ 40 lacs being Shares purchased in P.Y. 2011-12 and P.Y. 2012-13 **plus** ₹ 15 lacs being payment to contractor for construction of residential house in P.Y. 2009-10 **(**payment of ₹ 10 lacs relevant to P.Y. 2008-09 cannot be included as it is beyond ten assessment years)

c. search was conducted after 01.04.2017.

Hence, the contention of Miss. Priyanka Ravi that the Assessing Officer cannot issue the notice under section 153A beyond six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted under section 132 **is incorrect**.

The action of Assessing Officer is **partly correct** as it is possible to him to issue notice beyond six assessment years but not beyond ten assessment years from the assessment year relevant to the previous year in which search is conducted or requisition is made. Thus, he cannot issue the notice under section 153A for the A.Y.2009-10.

Section B – Additional Questions

Question 27

State with brief reason, whether the following statements are true or false:

(i) Where a notice under section 143(2) is issued to the assessee, it is not required to process under section 143(1), the return of income filed by the assessee.
(ii) Even without rejecting the books of account, if any, maintained by the assessee, the Assessing Officer can make a reference to the Valuation Officer under section 142A for estimating the cost of construction of an immovable property.
(iii) Expenses of special audit conducted under section 142 shall be paid by the Central Government.
(iv) Only an individual can be regarded as a Tax Return Preparer under section 139B.

Answer

(i) The statement is false

In respect of returns furnished for A.Y.2017-18 or thereafter, processing of a return under section 143(1) is necessary even where a notice has been issued to the assessee under section 143(2).

(ii) The statement is true

Section 142A(2) provides that the Assessing Officer may make a reference to the Valuation Officer whether or not he is satisfied about the correctness or completeness of the accounts of the assessee. Thus, even without rejecting the books of accounts maintained by the assessee, the Assessing Officer may make reference to the Valuation Officer under section 142A.

(iii) The statement is true

Where the direction for special audit is issued by the Assessing Officer, the expenses of, and incidental to, such special audit, shall be determined by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner in accordance with the prescribed guidelines. The expenses so determined shall be paid by the Central Government.

(iv) The statement is true

The definition of Tax Return Preparer includes only an individual who has been authorised to act as a Tax Return Preparer under the Scheme framed under section 139B.

Question 28

For the Assessment Year 2019-20, Mr. John, was directed to carry out a special audit of his accounts under section 142(2A) on 1.8.2019, without giving him an opportunity of being heard.

Answer the following questions in this regard:

(i) Can the assessee contend that since reasonable opportunity of being heard is not provided to him by the Assessing Officer, such notice requiring the special audit of accounts is not valid?

(ii) If the assessee decides to get his books of account audited under section 142(2A), what will be the due date by which he has to submit the audit report (including the extended time, if any, allowed to him)?

(iii) If the assessee intentionally does not comply with the directions. How much penalty can be levied on him?

(iv) For failure to get the books of account audited 'under section 142(2A), can prosecution proceedings be launched against the assessee? If yes, what will be the quantum of punishment for such default?

(v) Can the assessee approach the Settlement Commission to grant immunity from penalty and prosecution proceedings initiated against him? If yes, discuss the power of Settlement Commission to grant immunity in this regard.

Answer

(i) As per the proviso to section 142(2A), the Assessing Officer shall not direct the assessee to get the accounts audited unless the assessee has been given a reasonable opportunity of being heard.

Accordingly, the contention of the assessee that notice requiring special audit is not valid since reasonable opportunity of being heard has not been provided to him by the Assessing Officer **is correct**.

(ii) The maximum period (including extended time, if any, allowed) within which the assessee has to submit his audit report is 180 days from 1.8.2019, being the date on which direction to carry out a special audit of accounts under section 142(2A) is received by the assessee. Accordingly, in this case, the assessee has to submit his audit report by 27.1.2020.

(iii) Penalty of ₹ 10,000 is leviable under section 272A(1)(d) for failure to comply with a direction issued under section 142(2A).

(iv) If the assessee wilfully fails to comply with a direction issued to him under section 142(2A), he shall be punishable with rigorous imprisonment for a term which may extend to one year and with fine under section 276D.

(v) The assessee can approach the Settlement Commission to grant immunity from penalty and prosecution, if the additional amount of income-tax payable on income disclosed in the settlement application exceeds ₹ 50 lakh, where the assessee is the subject matter of search and ₹ 10 lakh, in other cases.

If the Settlement Commission is satisfied that the assesse has co-operated with it in the conduct of proceedings before it and has made a true disclosure of income, and the manner in which such income has been derived, it may grant to such person immunity from penalty and prosecution for failure to comply with direction under section 142(2A).

However, the Settlement Commission cannot grant immunity from prosecution where prosecution proceedings have been initiated before the date of receipt of application under section 245C.

Question 29

Mr. Hari, aged 65 years, is a resident and ordinarily resident in India for the A.Y.2020-21. He owns a house property in Dubai, which he purchased on 30.4.2010, and he also has a bank account in the Bank of Dubai.

(a) Mr. Hari contends that since his total income of ₹ 2,80,000 for the P.Y.2019-20, comprising of income from house property and bank interest, is less than the basic exemption limit, he need not file his return of income for A.Y.2020-21.

(b) Mr. Hari also contends that the notice issued by the Assessing Officer under section 148 in June, 2019 for A.Y.2011-12 is not valid due to the following reasons –

(i) There is no escaped income relating to that year; and

(ii) The time period prescribed in section 149 for issuing notice under section 148 for A.Y.2011-12 has since lapsed.

Discuss the correctness of the above contentions of Mr. Hari.

Answer

(a) The first contention of Mr. Hari is not correct.

Section 139(1) requires every resident other than not ordinarily resident, who at any time during the previous year, holds as a beneficial owner or otherwise, any asset (including financial interest in any entity) located outside India or has signing authority in any account located outside India or is a beneficiary of any asset located outside India, to file a return of income compulsorily whether or not he has income chargeable to tax. Mr. Hari has a house property in Dubai and a bank account in the Bank of Dubai. Therefore, Mr. Hari has to file his return of income mandatorily for the A.Y.2020-21, even though his total income of ₹ 2,80,000, comprising solely of income from house property and bank interest, is less than the basic exemption limit of ₹ 3,00,000 applicable to a senior citizen.

(b) Mr. Hari's second contention is also not correct.

Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person is found to have any asset (including financial interest in any entity) located outside India. Accordingly, the Assessing Officer can serve a notice under section 148 on such assessee requiring him to furnish a return of income within the specified period, for the purpose of making an assessment, reassessment or re- computation under section 147.

Further, section 149 prescribes an extended time limit of sixteen years for issue of notice under section 148, in case income in relation to such assets located outside India has escaped assessment.

In this case, since Mr. Hari has a house property located outside India in the P.Y.2010-11, income is deemed to have escaped assessment for A.Y.2011-12. Notice under section 148 issued to Mr. Hari in June 2020 in respect of A.Y.2011-12 is valid, since the extended time limit of sixteen years from the end of the relevant assessment year has not expired.

Question 30

"Nargis", a resident of India, owned for the financial year ended on 31-03-2020, a house property in London purchased in July, 2009; a shop in Sydney purchased in June, 2011 and space in a commercial complex in New York purchased in April, 2017. She is also having authority to operate the bank account (maintained with Citibank, London) of a company owned by her daughter and son-in-law since July, 2018.

She has been served in July, 2020 with the notices issued under section 148 of the Act for assessment years 2008-09 to 2019-20. She, for the reason of challenging the action of the Assessing Officer for issuing notices under section 148 for last 12 years, seeks your opinion. Advise her suitably.

Answer

Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person, being a resident other than not ordinarily resident in India, holds, as a beneficial owner or otherwise any asset located outside India or is a beneficiary of any asset located outside India or has a signing authority in any account located outside India. Accordingly, the Assessing Officer can serve a notice under section 148 on such assessee requiring him to furnish a return of income within the specified period, for the purpose of making an assessment, reassessment or recomputation under section 147.

Under section 149, an extended time limit of sixteen years is available for issue of notice under section 148 for an assessment or reassessment, in case income in relation to such assets located outside India has escaped assessment.

In this case, income chargeable to tax shall be deemed to have escaped assessment for the purpose

of section 147, since Nargis has assets located outside India.

Therefore, on this basis, the Assessing Officer formed a belief that the income has escaped assessment and consequently, issued notice under section 148 for 12 assessment years i.e. from A.Y.2008-09 to A.Y.2019-20.

Hence, the Assessing Officer is justified in invoking reassessment provisions in respect of the earlier assessment years also. However, the extended time limit of 16 years for invoking reassessment proceedings would be available only in respect of A.Y.2010-11 and thereafter, since Nargis first purchased an asset outside India only in July 2009.

Accordingly, in view of the above provisions, the action of the Assessing Officer in issuing notices to Nargis under section 148 for ten assessment years i.e., from A.Y. 2010-11 to A.Y. 2019-20 is in order. However, he cannot issue notice under section 148 for A.Y. 2008-09 and A.Y.2009-10, since the time limit of 4 years or 6 years, as the case may be, has since elapsed.

CHAPTER - 18
Appeals and Revision

Section A – ICAI Study Material Questions

Question 1

"SVS Propcon" did not make a claim of ₹ 20 lacs in the return of income filed for A.Y. 2020-21 which was disallowed in the previous assessment year under section 43B. However, the said claim was also not considered by the Assessing Officer during assessment proceedings on the ground that no revised return was filed. Can the assessee now make such claim before the appellate authority?

Answer

Yes, the assessee is entitled to raise additional claims before the appellate authorities.

The restriction that an additional claim has to be made by filing a revised return applies only in respect of a claim made before the Assessing Officer. An assessee cannot make a claim before the Assessing Officer otherwise than by filing a revised return. It was so held by the Supreme Court in Goetze (India) Ltd v. CIT (2006) 284 ITR 323.

However, this restriction does not apply to an additional claim made before an appellate authority. The appellate authorities have jurisdiction to permit additional claims before them, though, the exercise of such jurisdiction is entirely the authorities' discretion. It was so held by the Bombay High Court in CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336.

Thus, an additional claim can be raised before the Appellate Authority even if no revised return is filed.

Question 2

Examine the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961:

(i) An appeal before Income-tax Appellate Tribunal cannot be decided in the event of difference of opinion between the Judicial Member and the Accountant Member on a particular ground.

(ii) A High Court does not have an inherent power to review an earlier order passed by it on merits.

Answer

(i) The statement given is not correct. As per the provisions of section 255, in the event of difference in opinion between the members of the Bench of the Income-tax Appellate Tribunal, the matter shall be decided on the basis of the opinion of the majority of the members. In case the members are equally divided, they shall state the point or points of difference and the case shall be referred by the President of the Tribunal for hearing on such points by one or more of the other members of the Tribunal. Such point or points shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who had first heard it.

(ii) The statement given is not correct. The Supreme Court, in CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112, observed that the power of review would inhere on High Courts, being courts of record under article 215 of the Constitution of India. There is nothing in article 226 of the Constitution to preclude a High Court from exercising the power of review which

inheres in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it. The Supreme Court further observed that section 260A(7) does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under section 260A. The Supreme Court opined that this does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.

Question 3

Does the Income-tax Appellate Tribunal have the following powers?

(i) Power to allow the assessee to urge any ground of appeal which was not raised by him before the Commissioner (Appeals);

(ii) Power to recall its own order.

Answer

(i) The Income-tax Appellate Tribunal has the power to entertain question raised for the first time. The Tribunal is not confined only to the issues arising out of the appeal before the Commissioner (Appeals). It has the power to allow the assessee to urge any ground not raised before the Commissioner (Appeals). However, the relevant facts in respect of such ground should be on record. The decision of the Supreme Court in the case of National Thermal Power Company Limited vs. CIT (1998) 229 ITR 383 (SC) supports this view.

(ii) The Delhi High Court, in Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB) observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466, dealing with the Tribunal's power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then it is the duty of the Tribunal to set it right. The Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

Question 4

Can a rectification order under section 254 of the Income-tax Act, 1961 be passed by the Income-tax Appellate Tribunal beyond 6 months from the end of the month in which the order sought to be rectified was passed?

Answer

The issue as to whether a rectification order can be passed by the Income-tax Appellate Tribunal under section 254 beyond six months from the end of the month in which order sought to be rectified was passed, has been addressed in Sree Ayyanar Spinning and Weaving Mills Ltd. v. CIT (2008) 301 ITR 434 (SC). Section 254(2), dealing with the power of the Appellate Tribunal to pass an order of rectification of mistakes, is in two parts. The first part refers to the suo motu exercise of the power of rectification by the Appellate Tribunal, whereas the second part refers to rectification on an application filed by the assessee or Assessing Officer bringing any mistake apparent from the record to the attention of the Appellate Tribunal.

If Income-tax Appellate Tribunal, suo moto, makes the rectification of its order, then the order has to be passed within 6 months from the end of the month in which the order sought to be rectified was passed. Where the application for rectification is made by the Assessing Officer or the assesse within 6 months from the end of the month in which the order sought to be rectified was passed, the Appellate Tribunal is bound to decide the application on merits and not on the ground of limitation

i.e. order can be passed after expiry of 6 months from the end of the month in which the order sought to be rectified was passed. However, the application for rectification cannot be filed belatedly after 6 months from the end of the month in which the order sought to be rectified was passed. [Ajith Kumar Pitaliya vs ITO (2009) 318 ITR 182 (M.P.)]

Question 5

What do you mean by substantial question of law? Examine.

Answer

The expression "substantial question of law" has not been defined anywhere in the Act. However, it has acquired a definite meaning through various judicial pronouncements. The tests are:

(1) whether directly or indirectly it affects substantial rights of the parties; or

(2) the question is of general public importance; or

(3) whether it is an open question in the sense that issue is not settled by the pronouncement of the Supreme Court or Privy Council or by the Federal Court; or

(4) the issue is not free from difficulty; or

(5) it calls for a discussion for alternative view.

Question 6

Examine the correctness of the following statement:

"The Appellate Tribunal is empowered to grant indefinite stay for the demand disputed in appeals before it."

Answer

Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed.

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay.

Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. However, the aggregate of period originally allowed and the period so extended should not exceed 365 days even if the delay in disposing of the appeal is not attributable to the assessee. The Appellate Tribunal is required to dispose off the appeal within this extended period. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Therefore, the statement given in the question is not correct.

Question 7

Is Commissioner (Appeals) empowered to consider an appeal filed by an assessee challenging the order of assessment in respect of which the proceedings before the Settlement Commission abates? Examine.

Answer

Section 251(1) lists the powers of the Commissioner (Appeals) in disposing of an appeal. Clause (aa) of section 251(1) empowers the Commissioner (Appeals), in an appeal against the assessment order in respect of which the proceeding before the Settlement Commission abates under section 245HA, to confirm, reduce, enhance or annul the assessment after taking into consideration the following -

(1) all the material and other information produced by the assessee before the Settlement Commission;

(2) the results of the inquiry held by the Settlement Commission;

(3) the evidence recorded by the Settlement Commission in the course of the proceeding before it; and

(4) such other material as may be brought on his record.

Question 8

An Income-tax authority did not file an appeal to the Income-tax Appellate Tribunal against an order of the Commissioner (Appeals) decided against the Income-tax department on a particular issue in case of one assessee, Alpi for assessment year 2019-20 on the ground that the tax effect of such dispute was less than the monetary limit prescribed by CBDT. In assessment year 2020-21, similar issue arose in the assessments of Alpi and her sister Palki, which was decided by the Commissioner (Appeals) against the Department. Can the Income-tax department move an appeal to the Tribunal in respect of A.Y. 2020-21 against the orders of the Commissioner (Appeals) for Alpi and her sister Palki?

Answer

Under section 268A(1), the CBDT is empowered to issue orders, instructions or directions to the other income-tax authorities, fixing such monetary limits, as it may deem fit, to regulate filing of appeal or application for reference by any income-tax authority.

Under section 268A(2), where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to above-mentioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of the same assessee for any other assessment year or any other assessee for the same or any other assessment year. Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has

acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

In view of above provision, it would be in order for the Income-tax Department to move an appeal to the Tribunal against the orders of the CIT(A) in respect of A.Y. 2020-21 both for Alpi and Palki.

Question 9

A petition for stay of demand was filed before ITAT by XYZ Ltd. in respect of a disputed demand for which appeal was pending before it, on which stay was granted by the ITAT vide order dated 1.1.2019. The bench could not function thereafter till 1.2.2020 and therefore, the disputed matter could not be disposed off. The Assessing Officer attached the bank account on 16.2.2020 and recovered the amount of ₹ 15 lacs against the arrear demand of ₹ 25 lacs. The assessee requested the Assessing Officer to refund back the amount as it holds stay over it. The Assessing Officer rejected the contention of the assessee. Now the assessee seeks your opinion.

Answer

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay. Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. Section 254(2A) provides that the aggregate of the period originally allowed and the period or periods so

extended or allowed shall not, in any case, exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Accordingly, even if an appeal is not heard by the bench, say, due to the bench not functioning or due to the department seeking adjournment, the stay granted by the Appellate Tribunal shall stand vacated after the period of 365 days, inspite of the assessee having taken all steps to ensure speedy disposal of the appeal and having a good prima facie case.

In the present case, the period of 365 days has expired on 31.12.2019, after which date the order of stay stands vacated. Accordingly, the recovery of ₹ 15 lacs against the arrear demand of ₹ 25 lacs made by the Assessing Officer on 16.2.2020 is in order.

Question 10

An assessee who had been served with an order of assessment passed under section 143(3) on 1.1.2020 had filed an application against this order before the CIT as per section 264 on 11.1.2020. However, the CIT refused to entertain the application on the pretext of premature application. Assessee seeks your opinion.

Answer

An assessee, who is aggrieved by the order of the Assessing Officer under section 143(3) passed on 1.1.2020, had moved an application for revision of order under section 264 on 11.1.2020. The order passed by the Assessing Officer under section 143(3) is an order appealable before the Commissioner (Appeals). The time limit for filing an appeal is 30 days from the date of order i.e., upto 31.1.2020. This time limit had not expired on 11.1.2020 and the assessee had also not waived his right of appeal while filing the application for revision on 11.1.2020 before the Commissioner of Income-tax. The application filed before the Commissioner of Income-tax for revision under

section 264 by the assessee will only be considered when the conditions specified under section 264(4) have been complied with. One of the conditions is that the Commissioner shall not revise any order where an appeal against the order lies to the Commissioner (Appeals) or Appellate Tribunal and the time within which such appeal may be made has not expired, unless the assessee has waived his right of appeal. In the present case, the time limit had not expired on 11.1.2020 and the assessee had also not waived the right of appeal while filing the application for revision before the Commissioner of Income-tax on 11.1.2020 under section 264. Therefore, the Commissioner's refusal to entertain such application is correct.

Note : In practical situations, the Commissioner could have kept the proceedings in abeyance till the expiry of the time prescribed for filing appeal by the assessee and thereafter, could have assumed jurisdiction for making revision besides taking an undertaking from the assessee for waiving his right of appeal. In reality, taxpayers usually will not prefer revision in such short time period nor would the Commissioner reject the application, the moment it is received by him.

Question 11

(a) The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143. During the pendency of proceedings before the Commissioner, on the basis of material gathered during survey under section 133A after issue of the first notice, the Commissioner of Income-tax issued a second notice, the contents of which were different from the contents of the first notice. Examine whether the action of the Commissioner is justified as to the second notice.

(b) Examine the circumstances where the appellant shall be entitled to produce additional evidence, oral or documentary, before the Commissioner of Income-tax (Appeals) other than the evidence produced during the proceedings before the Assessing Officer.

Answer

(a) The action of the Commissioner in issuing the second notice is not justified. The term "record" has been defined in clause (b) of Explanation to section 263(1). According to this definition "record" shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the Explanation to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner,

Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be "record" available at the time of examination as emphasized in Explanation (b) to section 263(1).

(b) As per Rule 46A(1) of the Income-tax Rules 1962, an appellant shall be entitled to produce before the Commissioner (Appeals), evidence, either oral or documentary, other than the evidence produced by him during the course of proceedings before the Assessing Officer, only in the following circumstances -

(a) where the Assessing Officer has refused to admit evidence which ought to have been admitted; or

(b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Assessing Officer; or

(c) where the appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence which is relevant to any ground of appeal; or

(d) where the Assessing Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.

Further, no evidence shall be admitted unless the Commissioner (Appeals) records in writing the reasons for its admission.

Question 12

Examine the correctness or otherwise of the following propositions in the context of the Income-tax Act, 1961:

(a) The powers of the Commissioner of Income-tax (Appeals) to enhance the assessment are plenary and quite wide.

(b) At the time of hearing of rectification application, the Income-tax Appellate Tribunal can re-appreciate the evidence produced during the proceedings of the appeal hearing.

(c) The High Court cannot interfere with the factual finding recorded by the lower authorities and the Tribunal, without any valid reasons.

Answer

(a) The proposition is correct in law. The Supreme Court has, in CIT vs. McMilan & Co. (1958) 33 ITR 182 and CIT vs. Kanpur Coal Syndicate (1964) 53 ITR 225, held that in disposing of an appeal before him, the appellate authority can travel over a whole range of the assessment order. The scope of his powers is co-terminus with that of the Assessing Officer. He can do what the Assessing Officer can do and can also direct him to do, what he has failed to do. He can assess income from sources which have been considered by the Assessing Officer but not brought to tax. He can consider every aspect of the assessment order and give appropriate relief.

The Allahabad High Court has, in CIT v. Kashi Nath Chandiwala (2006) 280 ITR 318, held that the appellate authority is empowered to consider and decide any matter arising out of the proceedings in which the order appealed against was passed notwithstanding the fact that such matter was not raised before him by the assessee. The Commissioner (Appeals) is entitled to direct additions in respect of items of income not considered by Assessing Officer.

Further, the Apex Court has, in the case of Jute Corporation of India Ltd. vs. CIT (1991) 187 ITR 688, held that the appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter.

Thus, the powers of the Commissioner of Income-tax (Appeals) in enhancing the assessment are very wide and plenary.

(b) The proposition is not correct as per law. This is because section 254(2) specifically empowers the Appellate Tribunal to amend any order passed by it, either suo-moto or on an application made by the assessee or Assessing Officer, with a view to rectify any mistake apparent from record, at any time within **6 months** from the end of the month of the order sought to be amended.

The powers of the Tribunal u/s 254(2) relating to rectification of its order are very limited. Such powers are confined to rectifying any mistake apparent from the record. The mistake

has to be such that for which no elaborate reasons or inquiry is necessary. Accordingly, the re-appreciation of evidence placed before the Tribunal during the course of the appeal hearing is not permitted. It cannot re-adjudicate the issue afresh under the garb of rectification [CIT vs. Vardhman Spinning (1997) 226 ITR 296 (P & H), CIT v. Ballabh Prasad Agarwalla (1998) 233 ITR 354 (Cal.) & Niranjan & Co. Ltd. v. ITAT (1980) 122 ITR 519 (Cal.)]

(c) The proposition is correct in law. A finding of fact cannot be disturbed by the High Court in exercise of its powers under section 260A. The Income-tax Appellate Tribunal is the final fact finding authority and the findings of fact recorded by the Tribunal can be interfered with by the High Court under section 260A only on the ground that the same were without evidence or material, or if the finding is contrary to the evidence, or is perverse or there is no direct nexus between conclusion of fact and the primary fact upon which that conclusion is based.

In CIT vs. P. Mohanakala (2007) 291 ITR 278 and M. Janardhana Rao v. Joint CIT (2005) 273 ITR 50, the Apex Court observed that the High Court had set aside the factual findings of the lower authorities and the Tribunal without any valid reason. The Apex Court held that the findings of fact could not be interfered with by the High Court without carefully considering the facts on record, the surrounding circumstances and the material evidence. There is no scope for interference with the factual findings, unless the findings are per se without reason or basis, perverse and/or contrary to the material on record.

Hence, only if the issue gives rise to a substantial question of law, an appeal shall lie before the High Court.

Question 13

Answer the following in the context of provisions contained in the Income-tax Act, 1961:

The assessment for A.Y. 2016-17 was completed as per section 143(3) considering the various claims so made by the assessee on 23.12.2017. Subsequently, this was reopened under section 147 on certain issues, but excluding the claim of the assessee as to "Lease Equalisation Fund". The order of reassessment was passed on 18.11.2018. The Commissioner within the powers vested under section 263 passed an order on 11.4.2020 rejecting the claim of assessee as to "Lease Equalisation Fund". The assessee challenges that the action of the CIT is not sustainable because the same was barred by limitation.

Answer

This issue was settled by the Supreme Court in CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1.

The Supreme Court observed that though there was no doubt that once an order of assessment is reopened, the previous assessment will be held to be set aside and the whole proceedings would start afresh, however, it would not mean that even when the subject-matter of reassessment is distinct and different, the entire proceeding would be deemed to have been reopened. The doctrine of merger would apply only in a case where the subject-matter of reassessment and the subject-matter of assessment are the same. However, in this case, the revision proceedings related to Lease Equalisation Fund, which was not the subject matter of reassessment. Therefore, the doctrine of merger does not apply in this case.

Section 263(2) provides no order shall be made under section 263(1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed. The period of limitation as referred to in section 263(2) relates to the assessment in which the claim of the assessee as to Lease Equalisation Fund was considered by the Assessing Officer. This issue was not the subject matter of reassessment proceedings.

Accordingly, the period of limitation shall be reckoned with reference to the original assessment order and not from the date of the order of reassessment. Therefore, in this case, the revision

proceedings are barred by limitation since the original assessment order was made on 23.12.2017 and the revision should have been made by 31.3.2020.

Question 14

An assessee, who is aggrieved by all or any of the following orders, is desirous to know the available remedial recourse and the time limit against each order under the Income-tax Act, 1961:

(i) passed under section 143(3) by the Assessing Officer.
(ii) passed under section 263 by the Commissioner of Income-tax.
(iii) passed under section 272A by the Director General.
(iv) passed under section 254 by the ITAT.

Answer

(i) An assessee, aggrieved by the order passed under section 143(3) by the Assessing Officer, can file an appeal before the Commissioner of Income-tax (Appeals) under section 246A(1) within 30 days of the date of service of the notice of demand relating to the assessment. However, where the assessee does not want to prefer an appeal, then he can move a revision petition before the Principal Commissioner or Commissioner of Income-tax under section 264 within a period of one year from the date of on which the order was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

(ii) An assessee, aggrieved by the order passed under section 263 by the Commissioner of Income-tax, can file an appeal to Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iii) An assessee, aggrieved by the order passed under section 272A by the Director General, can file an appeal before the Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iv) An assessee, aggrieved by the order passed under section 254 by the Income-tax Appellate Tribunal, can file an appeal before the High Court under section 260A within 120 days from the date of receipt of order of Income-tax Appellate Tribunal, only where the order gives rise to a substantial question of law.

Question 15

Who can file memorandum of cross-objections before the Income-tax Appellate Tribunal? What is the time limit? What is the fee for filing memorandum of cross objections?

Answer

Section 253(4) of the Income-tax Act, 1961 gives the respondent (assessee or the Assessing Officer), in every appeal filed before the Income-tax Appellate Tribunal, a right to file a memorandum of cross-objections against any order of the Commissioner (Appeals). This right of filing a memorandum of cross-objections is an independent right given to the respondent in an appeal and is in addition to the right of appeal which may or may not be exercised by the assessee or the Assessing Officer under section 253(1) or section 253(2). The memorandum of cross-objections has to be in the prescribed form and verified in the prescribed manner and has to be filed within 30 days of the receipt of notice of the appeal. The Tribunal is empowered to permit filing of memorandum of cross-objections after the expiry of the prescribed period if sufficient cause is shown. Such memorandum of cross-objections will be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in section 253(3). There is no fee for filing a memorandum of cross-objections.

Section B – Additional Questions

Question 16

Assessment of Bhajan Ltd. was completed under section 143(3) with an addition of ₹ 15 lakhs to the returned income. The assessee-company preferred appeal before the Commissioner (Appeals) which is pending now.

In this backdrop, answer the following:

(i) Based on fresh information that there was escapement of income for the same assessment year, can the Assessing Officer initiate reassessment proceedings when the appeal is pending before Commissioner (Appeals)?

(ii) Can the Assessing Officer pass an order under section 154 for rectification of mistake in respect of issues not being subject matter of appeal?

(iii) Can the assessee-company seek revision under section 264 in respect of matters other than those preferred in appeal?

(iv) Can the Commissioner make a revision under section 263 both in respect of matters covered in appeal and other matters?

Answer

(i) As per the third proviso to section 147, the Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment. The doctrine of partial merger would apply in this case.

Therefore, even when an appeal is pending before Commissioner (Appeals), the Assessing Officer can initiate reassessment proceedings in respect of income chargeable to tax which has escaped assessment, provided such income is not the subject matter of the appeal before the Commissioner (Appeals) i.e., such income which has escaped assessment does not form part of the additions of ₹15 lakhs to the returned income, which is the subject matter of appeal.

(ii) As per section 154(1A), the Assessing Officer can pass an order under 154(1) to rectify a mistake apparent from the record, provided the rectification is in relation to a matter, other than the matter which has been considered and decided in the appeal before Commissioner (Appeals). The doctrine of partial merger holds good for section 154 also.

Since the issue under consideration in this case relates to rectification of a mistake in respect of a matter which is not the subject matter of appeal, the Assessing Officer can pass an order under section 154 for rectification of the same provided the same is a mistake apparent from the record.

(iii) As per section 264(4), the Commissioner shall not revise any order under section 264, where such order has been made the subject of an appeal to the Commissioner (Appeals). Thus, the concept of total merger would apply in the case of section 264.

Therefore, under section 264, the Commissioner cannot revise an order which is pending before the Commissioner (Appeals), even if the revision pertains to a matter, other than the matter(s) covered in the appeal.

(iv) As per section 263, the Commissioner has the power to revise an order prejudicial to revenue, even if the order is the subject matter of appeal before Commissioner (Appeals). However, the power of the Commissioner under section 263 shall extend to only such matters as had not been considered and decided in such appeal. Here again, the doctrine of partial merger would apply.
In a case where the appeal is pending but not yet decided, the Commissioner cannot exercise his revisionary jurisdiction in respect of those issues which are the subject matter of appeal.

Question 17

An Assessee, who is aggrieved by all or any of the following orders, is desirous to know the remedial recourse and the time limit against each order under the Income- tax Act, 1961 -

(1) Passed under section 153A (except an order passed in pursuance of the direction of the Dispute Resolution Panel) by the Assessing Officer.

(2) Passed under section 263 by the Commissioner of Income-tax.

(3) Passed under section 272A by the Principal Commissioner.

(4) Passed under section 254 by the ITAT.

Answer

Remedial measures against certain orders and time limit

	Order passed u/s	Remedy available	Time limit
1.	153A	File an appeal before the Commissioner (Appeals) u/s 246A(1)	Within **30 days** of the date of service of the notice of demand relating to the assessment.
		(or) Move a revision petition u/s 264 before the Commissioner or Principal Commissioner	Within a period of **one year** from: (i) the date of on which the order was communicated to him; or (ii) the date on which he otherwise came to know of it, whichever is earlier.
2.	263	File an appeal before the Appellate Tribunal (ITAT) u/s 253(1)(c)	**within 60 days** of the date on which the order sought to be appealed against is communicated to the assessee.
3.	272A	File an appeal before the Appellate Tribunal (ITAT) u/s 253(1)(c)	**within 60 days** of the date on which the order sought to be appealed against is communicated to the assessee.
4.	254	File an appeal before the High Court u/s 260A	**within 120 days** from the date of receipt of order of ITAT

CHAPTER - 19
Settlement of Tax Cases

Section A – ICAI Study Material Questions

Question 1

X & Co Ltd. had made an application to the Settlement Commission. The issue in the said application related to cash credits in the books of account. The Commission passed an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax. Discuss the validity of the order of the Settlement Commission.

Answer

The issue under consideration is whether the Settlement Commission can pass an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax.

Section 245D(4) provides that the Settlement Commission, after examination of records and the report of the Commissioner and after examining such further evidence as may be placed before it or obtained by it, may, in accordance with the provisions of the Act, pass such order as it thinks fit.

Further, section 245D(5) provides that the materials brought on record before the Settlement Commission shall be considered by the Members of the concerned Bench before passing any order under section 245D(4).

"Consideration" means independent examination of the evidence and material brought on record before the Settlement Commission by the members and application of mind thereto with a view to independently assess the materials and evidence, whether adduced by the applicant or by the Commissioner, and come to a conclusion by themselves.

This view has been upheld in case of Supreme Agro Foods P Ltd. v. Income-tax Settlement Commission (2013) 353 ITR 385 (P&H)

The Settlement Commission, therefore, has to consider the material brought on record before it and "consideration" means independent examination of the evidence and material on record.

In this case, since the material was available before the Settlement Commission and such material has been taken into consideration for returning a finding which is relevant for determining the undisclosed income of the applicant, the addition made on the basis of difference in gross profit rate adopted is justified.

Therefore, the order of the Settlement Commission is valid.

Question 2

On an application made by Mr. Pandey, an order was passed by the Settlement Commission on 03-01-2020 under Section 245D(6B). The said order had a mistake apparent on record. The Settlement Commission suo moto passed an amended order dated 30-07-2020 which resulted in modifying the liability of Mr. Pandey.

Mr. Pandey is of the view that order of the Settlement Commission is final and conclusive and it has no power to rectify the said mistake.

You are required to examine the following:
(i) Correctness of claim made by Mr. Pandey
(ii) Validity of the order amended by the Settlement Commission

Answer

(i) Under section 245F(1), the Settlement Commission has been conferred all the powers which are vested in an income-tax authority under the Act. Under section 154, an income-tax authority has the power to amend any order passed by it in order to rectify any mistake apparent from the record. Therefore, the Settlement Commission's power to amend an order to rectify any mistake apparent from the record is embedded in section 245F(1).

Further, in order to reflect the correct intention of the legislature, section 245D(6B) specifically provides that the Settlement Commission may, at any time within a period of six months from the end of the month in which the order was passed, amend any order passed by it under section 245D(4) to rectify any mistake apparent from the record. In this case, the rectification order was passed by the Settlement Commission within six months from the end of the month in which the order was passed (i.e. by 31.7.2020)

Therefore, Mr. Pandey's view is not correct.

(ii) In this case, the rectification has the effect of modifying the liability of Mr. Pandey. Therefore, as per the second proviso to section 245D(6B), the Settlement Commission, before passing the amended order, should have –

(1) given a notice to the applicant and the Principal Commissioner/Commissioner of its intention to make such an amendment; and

(2) allowed the applicant and the Principal Commissioner/Commissioner an opportunity of being heard.

If these conditions are fulfilled, the order amended by the Settlement Commission would be a valid order, since the amended order is passed by the Settlement Commission within the permitted time limit i.e., within six months from the end of the month in which the original order was passed.

However, if the Settlement Commission has not given notice of its intention to make such an amendment or has not allowed the applicant and Principal Commissioner/ Commissioner an opportunity of being heard, then, amended order passed by it will not be valid.

Question 3

Seizures were made from Mr. Sunder pursuant to a search conducted in his premises. He filed an application for settlement by claiming to have received the amount by way of loans from several persons. The Settlement Commission accepted his statement and made an order. The CBI, however, conducted enquiry at the instance of the Revenue regarding the claimed amount of loans and opined that the alleged lenders had no means or financial capacity to advance such huge loans to Mr. Sunder and were mere name lenders only. The Commissioner filed an application under section 245D(6) praying for the order to be declared void and for withdrawal of benefit granted. Mr. Sunder, however, contended that the order of the Settlement Commission was final and any fresh analysis would amount to sitting in judgement over an earlier decision, for which the Settlement Commission was not empowered. Discuss the correctness of Mr. Sunder's contention.

Answer

The Apex Court, in CIT vs. Om Prakash Mittal (2005) 273 ITR 326, observed that a plain reading of section 245D(6) shows that every order passed under sub-section (4) has to provide for:-

(i) the terms of settlement; and

(ii) that the settlement would become void, if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

The decision that the order has been obtained by fraud or misrepresentation is that of the Settlement Commission. However, there is no requirement that the action be initiated by the Settlement Commission, suo moto. The Revenue can move the Settlement Commission for decision on an issue if it has material to show that the order was obtained by fraud or misrepresentation of facts.

The Supreme Court observed that the foundation for settlement is an application which an assessee can file at any stage of a case relating to him in such form and manner as may be prescribed. The fundamental requirement of the application under section 245C is that there must be full and true disclosure of the income along with the manner in which it has been derived. If an order is obtained by fraud or misrepresentation of facts, it cannot be said that there is a full and true disclosure and therefore, the Legislature has prescribed the condition relating to declaration of the order void when it is obtained by fraud or misrepresentation of facts.

The Supreme Court held that merely because section 245-I provides that the order of settlement is conclusive, it does not take away the power of the Settlement Commission to decide whether the settlement order has been obtained by fraud or misrepresentation of facts. If the Commissioner is able to establish that the earlier decision was void because of misrepresentation of facts, then it is open for the Settlement Commission to decide the issue. It cannot be called by any stretch of imagination to be a review of the earlier judgment or the subsequent Bench sitting in appeal over the earlier Bench's decision.

Mr. Sunder's contention is, therefore, not correct.

Question 4

Does the Settlement Commission have the power to reduce or waive interest levied under sections 234A, 234B and 234C of the Income-tax Act? Discuss.

Answer

The matter concerning the power of the Settlement Commission to reduce or waive interest chargeable under section 234A, 234B or 234C has been settled by the Supreme Court in CIT v. Anjum M.H.Ghaswala (2001) 252 ITR 1.

According to the judgment, the provisions of section 245D(6) are only procedural in nature providing for fixing the term by which the amounts settled under sub-section (4) will have to be paid. It does not empower the Commission either to reduce or waive the interest. Any settlement made by the Commission must be in accordance with the provisions of the Act.

The Settlement Commission does not have the power to reduce or waive the interest levied under sections 234A, 234B and 234C. It does not authorize the waiver or deduction of tax. The levy of interest under sections 234A, 234B or 234C is mandatory in nature and therefore any settlement made must include the interest under these sections. However, as per provisions of section 245F, the Settlement Commission shall have all the powers which are vested in an income-tax authority. Therefore, Settlement Commission can grant relief from the aforesaid interest to the extent of the powers given vide the circulars issued by CBDT under section 119.

Question 5

(a) Does the Settlement Commission have jurisdiction to entertain an application made under section 245C(1) in respect of a case covered by Chapter XIV-B (Search and seizure case).

(b) Discuss the power of the Settlement commission to grant immunity from prosecution and penalty.

Answer

(a) Section 245A(b) defines the term ₹case' to mean any proceeding for assessment under the Act of any person in respect of any assessment year or years which is pending before the Assessing Officer on the date on which an application is made to the Settlement Commission.

Search cases are eligible for settlement through the Settlement Commission. Explanation to section 245A(b), provides that in case of a person referred to in section 153A or section 153C, a proceeding for assessment or reassessment shall be deemed to have been commenced on the date of issue of notice initiating such proceeding for assessment under section 153A or section 153C and concluded on the date on which the assessment is made. During this period, application for settlement of the case could be filed by the assessees.

Further, section 245C provides that an application before the settlement commission in cases falling under section 153A and 153C can be made, where the additional amount of income-tax payable on income disclosed in the application exceeds ₹50 lakh, in respect of the tax payer who is the subject matter of search and ₹ 10 lakh, in respect of entities related to such a tax payer, who are also the subject matter of search.

Moreover, such tax and interest thereon, which would have been payable had such income been disclosed in the return of income before the Assessing Officer on the date of application, should be paid on or before the date of making the application. Further, proof of such payment should be attached with the application.

(b) The power of Settlement Commission to grant immunity from prosecution and penalty is provided for in section 245H.

In respect of an application made on or after 1st June, 2007, the Settlement Commission's power to grant immunity from prosecution is restricted to offences under the Income-tax Act, 1961. The Settlement Commission can also grant immunity from penalty imposed under the Income-tax Act, 1961. Such immunity from prosecution and penalty may be granted subject to conditions as it may think fit to impose.

However, the Settlement Commission may grant immunity only if the person who has made the application has co-operated with the Settlement Commission and made a full and true disclosure of his income and the manner in which it was derived. Further, the Settlement Commission while granting immunity to any person from prosecution shall record the reasons in writing in the order passed by it.

Also, the Settlement Commission cannot grant immunity if the prosecution proceeding for any such offence has been instituted before the date of receipt of application for settlement under section 245C.

Question 6

The business premises of Mr. Amit was subjected to a survey under section 133A of the Act. There were some incriminating materials found at the time of survey. The assessee apprehends reopening of assessments of the earlier years. He wants to know whether he can approach the Settlement Commission.

Explain briefly the basic conditions to be satisfied and the benefits that may accrue to Mr. Amit by approaching the Settlement Commission.

Answer

An assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C. "Case" means any

proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. Thus, the basic condition for making an application before the Settlement Commission under section 245C is that there must be a proceeding for assessment pending before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment or recomputation under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued.

In this case, Mr. Amit cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since there would be a "case pending" before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed ₹ 10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payment should be attached with the application.

If the Settlement Commission is satisfied that Mr. Amit has co-operated in the proceedings and made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Amit -

(i) immunity from prosecution for any offence under the Income-tax Act, 1961, where the proceedings for such prosecution have been instituted on or after the date of receipt of application under section 245C; and

(ii) immunity from imposition of penalty under the Income-tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement.

This is the benefit that may accrue to Mr. Amit, if he approaches the Settlement Commission.

Note: Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years has not been issued but could have been issued on date. However, a return of income for such other assessment years should have been furnished under section 139 or the response to notice under section 142.

Question 7

Explain the powers of Settlement Commission to amend its order.

Answer

As per the section 245D(6B), the Settlement Commission may amend any order passed by it under section 245D(4) to rectify a mistake apparent from the record, within six months from the end of the month in which order was passed.

In case where an application for rectification is made by the Principal Commissioner or the Commissioner or the applicant within 6 months from the end of the month in which order under section 245D(4) was passed, the Settlement Commission may amend the order within six months from the end of the month in which an application for rectification has been made by the Principal Commissioner or Commissioner or the applicant.

However, an amendment which has the effect of modifying the liability of the applicant shall not be made unless the Settlement Commission –

(1) has given notice to the applicant and the Principal Commissioner or Commissioner of its intention to do so; and

(2) has allowed the applicant and the Principal Commissioner or Commissioner an opportunity of being heard.

Question 8

M/s. A Ltd. has received a notice under section 148 for the Assessment Year 2017-18 on 02-02-2019. They also anticipate similar notices for the Assessment Years 2015-16 and 2016-17 for which they have already furnished return of income. On examination of the books of account produced, you have noticed huge amounts of concealed income. As a consultant, what is your advice to A Ltd.?

Answer

As per section 245C, an assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission.

"Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made.

A proceeding for assessment or reassessment or recomputation under section 147 is deemed to have commenced from the date of issue of notice under section 148. Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years have not been issued but could have been issued on that date. However, a return of income for such other assessment years should have been furnished under section 139 or in response to notice under section 142.

In the case on hand, M/s A Ltd. has received a notice under section 148 for the A.Y.2017-18 and also anticipates similar notices for the A.Y.2015-16 and A.Y.2016-17, for which return of income has been furnished. Thus, a proceeding for assessment is pending before an Assessing Officer i.e., the basic condition for approaching Settlement Commission is satisfied.

Moreover, since after examination of the books of account, huge amount of concealed income is also noticed, it is presumed that the second condition that the additional amount of income-tax payable on the income disclosed in the application should exceed ₹ 10 lakhs has also been satisfied.

Based on these facts, assuming that the necessary conditions are fulfilled, our advice as consultant to M/s A Ltd. would be to approach the Settlement Commission to have his case settled and apply for grant of immunity from penalty and prosecution.

CHAPTER - 20
Penalties

Section A – ICAI Study Material Questions

Question 1

M/s. XYZ is a firm liable to tax@30%. The following are the particulars furnished by the firm for A.Y.2020-21:

	Particulars of total income	₹
(1)	As per the return of income furnished u/s 139(1)	50,00,000
(2)	Determined under section 143(1)(a)	60,00,000
(3)	Assessed under section 143(3)	75,00,000
(4)	Reassessed under section 147	95,00,000

Can penalty be levied u/s 270A on M/s. XYZ? If the answer is in the affirmative, compute the penalty leviable u/s 270A.

Answer

M/s. XYZ is deemed to have under-reported its income since:

(1) its income assessed u/s 143(3) exceeds its income determined in a return processed u/s 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed u/s 143(3). Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3) Under-reported income:		
Total income assessed under section 143(3)	75,00,000	
(-) Total income determined u/s 143(1)(a)	60,00,000	
	15,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 15 lakhs plus tax on total income of ₹ 60 lakhs determined u/s 143(1)(a) **[30% of ₹ 75 lakh + HEC@4%]**	23,40,000	
Less: Tax on total income determined u/s 143(1)(a) **[30% of ₹ 60 lakh +HEC@4%]**	18,72,000	
	4,68,000	
Penalty leviable@50% of tax payable		2,34,000
Reassessment under section 147 Under-reported income:		
Total income reassessed under section 147	95,00,000	
(-) Total income assessed under section 143(3)	75,00,000	
	20,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 20 lakhs plus tax on total income of ₹ 75 lakhs assessed u/s 143(3) **[30% of ₹ 95 lakh + HEC@4%]**	29,64,000	
Less: Tax on total income assessed u/s 143(3) **[30% of ₹ 75 lakh + HEC@4%]**	23,40,000	

	6,24,000	
Penalty leviable@50% of tax payable		3,12,000

Note – The following assumptions have been made -

(1) None of the additions or disallowances made in assessment or reassessment qualifies under section 270A(6); and

(2) The under-reported income is not on account of misreporting.

Question 2

Mr. Ram, a resident individual of the age of 55 years, has not furnished his return of income for A.Y.2020-21. However, the total income assessed in respect of such year under section 144 is ₹ 12 lakh. Is penalty u/s 270A attracted in this case, and if so, what is the quantum of penalty leviable?

Answer

Mr. Ram is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic exemption limit of ₹ 2,50,000. Hence, penalty under section 270A is leviable in his case.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 144		
Under-reported income:		
Total income assessed under section 144	12,00,000	
(-) Basic exemption limit	2,50,000	
	9,50,000	
Tax payable on under-reported income as increased by the basic exemption limit [30% of ₹ 2 lakhs + ₹ 1,12,500]	1,72,500	
Add: HEC@4%	6,900	
	1,79,400	
Penalty leviable@50% of tax payable		89,700

Note – It is assumed that the under-reported income is not on account of misreporting.

Question 3

ABC Ltd. is a domestic company liable to tax@25%. The following are the particulars furnished by the company for A.Y.2020-21:

	Particulars of total income	₹
(1)	As per the return of income furnished u/s 139(1)	(15,00,000)
(2)	Determined under section 143(1)(a)	(8,00,000)
(3)	Assessed under section 143(3)	(5,00,000)
(4)	Reassessed under section 147	4,00,000

Is penalty leviable under section 270A on ABC Ltd., and if so, what is the quantum of penalty?

Answer

ABC Ltd. is deemed to have under-reported its income since:

(1) the assessment u/s 143(3) has the effect of reducing the loss determined in a return processed u/s 143(1)(a); and

(2) the reassessment u/s 147 has the effect of converting the loss assessed u/s 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3) Under-reported income:		
Loss assessed u/s 143(3)	(5,00,000)	
(-) Loss determined under section 143(1)(a)	(8,00,000)	
	3,00,000	
Tax payable on under-reported income@25%	75,000	
Add: HEC@4%	3,000	
	78,000	
Penalty leviable@50% of tax payable		39,000
Reassessment under section 147 Under-reported income:		
Total income reassessed under section 147	4,00,000	
(-) Loss assessed under section 143(3)	(5,00,000)	
	9,00,000	
Tax payable on under-reported income@25%	2,25,000	
Add: HEC@4%	9,000	
	2,34,000	
Penalty leviable@50% of tax payable		1,17,000

Notes – The following assumptions have been made -

(1) None of the additions or disallowances made in assessment or reassessment qualifies u/s 270A(6); and

(2) The under-reported income is not on account of misreporting.

Question 4

A private bank has not filed its statement of financial transaction or reportable account in relation to the specified financial transactions for the financial year 2019-20. A notice was issued by the prescribed income-tax authority on 1st October, 2020 requiring the bank to furnish the statement by 31st October, 2020. The bank, however, furnished the statement only on 15th November, 2020. What would be the penalty leviable under section 271FA?

Answer

(1)	(2)	(3)	(4)	
Non-compliance of section	**Penalty under section 271FA**	**Period**	**Quantum of penalty under section 271FA**	
			(2) × (3)	**(₹)**
285BA(1)	₹ 500 per day of continuing default	1.6.2020 to 31.10.2020	153 days × ₹ 500	76,500
285BA(5)	₹ 1,000 per day of continuing default	1.11.2020 to 15.11.2020	15 days × ₹ 1,000	15,000
				91,500

Question 5

A search under section 132 was initiated in the premises of Mr. X on 30.4.2019 and undisclosed money and jewellery belonging to Mr. X was found in his premises. Examine the penal provisions under the Income-tax Act which are attracted in this case, assuming that the undisclosed assets were acquired out of his undisclosed income of previous year 2019-20.

Answer

In order to deter the practice of non-disclosure of income, section 271AAB(1A) provides for levy of penalty on undisclosed income found during the course of a search, which relates to specified previous year, i.e.-

- the previous year which has ended before the date of search, but the due date of filing return of income for the same has not expired before the date of search and the return has not yet been furnished (P.Y. 2018-19);
- the previous year in which search is conducted (P.Y. 2019-20).

Accordingly, under section 271AAB(1A), in respect of searches initiated on or after 15.12.2016,

- penalty@30% would be attracted, if undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, and furnishes the return of income for the specified previous year declaring such undisclosed income on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be).
- In all other cases, penalty @60% of undisclosed income would be attracted.

Question 6

What is the quantum of penalty that could be levied in each of the following cases -

(i) Failure to get books of accounts audited as required under section 44AB within the time prescribed under the Act.

(ii) Failure to comply with a direction issued under section 142(2A).

(iii) Failure to furnish report from an accountant as required under section 92E.

Answer

The penalty that could be levied in each case is:

(i) **Failure to get books of accounts audited as required under section 44AB of the Income-tax Act, 1961 -** a sum equal to ½% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of ₹ 1,50,000, whichever is less [Section 271B].

(ii) **Failure to comply with a direction issued under section 142(2A) –** a sum of ₹ 10,000 [Section 272A(1)(d)].

(iii) **Failure to furnish report from an accountant as required by section 92E -** a sum of ₹ 1,00,000 [Section 271BA].

Question 7

X, an individual whose total sales in the business of food grains for the year ending 31.3.2020 was ₹ 205 lakhs, did not maintain books of account for P.Y.2019-20, even though his turnover was ₹ 28 lakhs in the P.Y.2018-19. The Assessing Officer levied penalty of ₹ 25,000 under section 271A for non-maintenance of books of account and penalty of ₹ 1,02,500 under section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B?

Answer

X is required to maintain books of account as per section 44AA for the P.Y.2019-20 since his turnover exceeded ₹ 25 lakhs in the P.Y.2018-19. He also has to get them audited under section 44AB, since his gross sales in the P.Y.2019-20 exceeds ₹ 1 crore. He is liable to pay penalty under section 271A for not maintaining his books of account as per section 44AA. Accordingly, the action of the Assessing Officer in levying penalty of ₹ 25,000 under section 271A is correct. However, where books of account have not been maintained, there cannot be a question of getting them audited. Audit of books of account presupposes maintenance of books of account. When admittedly X has not maintained books, he cannot obviously get the audit done.

In Surajmal Parsuram Todi v. CIT (1996) 222 ITR 691, the Gauhati High Court has held that when a person commits an offence by not maintaining books of accounts as contemplated by section 44AA, the offence is complete and after that there can be no possibility of any offence as contemplated by section 44AB and, therefore, the imposition of penalty under section 271B is erroneous.

Therefore, in this case, the Assessing Officer is not justified in levying penalty under section 271B.

Question 8

State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) regarding the waiver of penalty. Can the Principal Commissioner or Commissioner refuse to grant relief, when the conditions laid down in the section was complied with, by the assessee?

Answer

There are two conditions to be satisfied by an assessee in order to get relief in the form of a waiver or reduction of penalty by the Principal Commissioner or Commissioner of Income-tax under section 273A(4) of the Act. These conditions are:

(i) The payment of penalty would cause "genuine hardship" to the assessee and the Commissioner is satisfied about the existence of genuine hardship having regard to the circumstances of the case. The existence of genuine hardship would entitle the assessee to relief. The CBDT in its Circular No 784 dated 22-11-1999 has clarified that "genuine hardship" referred to in the provisions of section 273A(4) should exist both at the time at which the application under section 273A(4) is made by the assessee before the Principal Commissioner or Commissioner and at the time of passing of order under section 273A(4) by the Principal Commissioner or Commissioner.

(ii) The assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

As per the decision of Andhra Pradesh High Court in K.S.N. Murthy v. Chairman, CBDT (2001) 252 ITR 269, if the above conditions laid down for exercise of the discretion are satisfied, the Principal Commissioner or Commissioner cannot refuse to exercise the discretion. Though the power given to the Commissioner under section 273A is discretionary, the exercise of discretion cannot be either arbitrary or capricious and has to be judicious and objective, once the conditions required for exercise of discretion in any judicial or quasi-judicial proceedings are satisfied. Such discretion

must be exercised taking into consideration all relevant facts. The satisfaction for exercise of discretionary power under the section must be based on objective consideration and not on subjective satisfaction.

Also, as per the proviso to section 273A(4), in case the quantum of penalty exceeds ₹ 1 lakh, the Principal Commissioner or Commissioner can grant relief only with the previous approval of the Principal Chief Commissioner or Chief Commissioner or the Principal Director General or Director General, as the case may be.

Note - The Principal Commissioner or Commissioner has to pass an order under section 273A(4), either accepting or rejecting the application in full or in part, within a period of 12 months from the end of the month in which the application is received. Further, no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard.

Question 9

An assessee had credited a sum of ₹ 50,000 in cash in the account of Madan, said to represent a loan obtained from him. The Assessing Officer, having gone into the genuineness of the transaction, disbelieved the story of loan and treated the sum of ₹ 50,000 as the income of the assessee from undisclosed sources. He also started proceedings under section 271D and levied a penalty of ₹ 60,000 on the assessee for having accepted the loan in contravention of section 269SS. Examine the correctness of the levy.

Answer

There are several flaws in the penalty levied by the Assessing Officer. Firstly, the penalty leviable under section 271D cannot exceed the sum equal to the loan taken. Hence, the maximum penalty leviable would be ₹ 50,000. Secondly, any penalty imposable under section 271D shall be imposed by the Joint Commissioner. Hence, unless the Assessing Officer happens to be a Joint Commissioner the levy of penalty will be invalid. Thirdly, the Assessing Officer cannot, on the one hand, treat the loan as undisclosed income of the assessee and on the other, treat it as a loan for the purpose of section 269SS read with section 271D. Such a treatment will be self-contradictory. The moment the amount of ₹ 50,000 is treated as undisclosed income, it ceases to bear the character of loan and therefore, the foundation for the levy of penalty under section 271D disappears. [Diwan Enterprises v. CIT and Others (2000) 246 ITR 571].

Question 10

Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act, 1961.

(i) Raman & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.

(ii) Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of ₹ 10,000. They have not furnished the requisite information in spite of various reminders.

Answer

(i) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Joint Commissioner. Therefore, Raman & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to

deduct under section 194C from the payments made to the contractors. The penalty would be in addition to the disallowance of 30% of expenditure/payment under section 40(a)(ia).

(ii) Section 133(6) empowers the Income-tax authority to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required makes him liable for penalty under section 272A(2) of ₹ 100 for every day during which the failure continues.

Note – In a case where no proceeding is pending, the Income-tax authority can exercise this power only after obtaining the approval of the Principal Director/Director or Principal Commissioner/Commissioner as the case may be. In this case, it is presumed that the Income-tax authority has obtained the approval of the Principal Director/Director or Principal Commissioner/ Commissioner before exercising this power.

Question 11

Fox Limited failed to furnish information and documents sought by the Transfer Pricing Officer (TPO). Can TPO levy penalty for such failure? How much would be the quantum of penalty imposable for the said failure?

Answer

Under section 271G, if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by section 92D(3) sought for by the Transfer Pricing Officer, then, such person shall be liable to a penalty which may be levied by the Assessing Officer or the Transfer Pricing Officer or the Commissioner (Appeals). Thus, the Transfer Pricing Officer is a competent authority to levy penalty.

Penalty would be a sum equal to 2% of the value of international transaction or specified domestic transaction for each such failure.

Question 12

What would be the penalty leviable under section 270A in case of the following assessees, if none of the additions or disallowances made in the assessment or reassessment qualify under section 270A(6) and the under-reported income is not on account of misreporting?

	Particulars of total income of A.Y.2020-21	**M/s. Alpha, a resident firm**	**Beta Ltd., an Indian company**
		(₹)	**(₹)**
(1)	As per the return of income furnished u/s 139(1)	35,00,000	(12,00,000)
(2)	Determined under section 143(1)(a)	45,00,000	(6,00,000)
(3)	Assessed under section 143(3)	62,00,000	(2,00,000)
(4)	Reassessed under section 147	81,00,000	6,00,000

Note – Beta Ltd. is a trading company. The total turnover of Beta Ltd. for the P.Y.2017-18 was ₹ 401 crore and the company has not exercised option under section 115BAA.

Answer

Penalty leviable under section 270A in case of M/s. Alpha, a resident firm

M/s. Alpha is deemed to have under-reported its income since:

(1) its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed under section 143(3). Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	62,00,000	
(-) Total income determined u/s 143(1)(a)	45,00,000	
	17,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 17 lakhs plus total income of ₹ 45 lakhs determined u/s 143(1)(a) **[30% of ₹ 62 lakh + HEC@4%]**	19,34,400	
Less: Tax on total income determined u/s 143(1)(a) **[30% of ₹ 45 lakh + HEC@4%]**	14,04,000	
	5,30,400	
Penalty leviable@50% of tax payable		2,62,200
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	81,00,000	
(-) Total income assessed under section 143(3)	62,00,000	
	19,00,000	
Tax payable on under-reported income		
Tax on under-reported income of ₹ 19 lakhs plus total income of ₹ 62 lakhs assessed u/s 143(3) **[30% of ₹ 81 lakh + HEC@4%]**	25,27,200	
Less: Tax on total income assessed u/s 143(3) **[30% of ₹ 62 lakh + HEC@4%]**	19,34,400	
	5,92,800	
Penalty leviable@50% of tax payable		2,96,400

Penalty leviable under section 270A in the case of Beta Ltd., an Indian company

Beta Ltd. is deemed to have under-reported its income since:

(1) the assessment under 143(3) has the effect of reducing the loss determined in a return processed under section 143(1)(a); and

(2) the reassessment under section 147 has the effect of converting the loss assessed under section 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3)		
Under-reported income:		
Loss assessed u/s 143(3)	(2,00,000)	
(-) Loss determined under section 143(1)(a)	(6,00,000)	
	4,00,000	
Tax payable on under-reported income@30%	1,20,000	
Add: HEC@4%	4,800	

	1,24,800	
Penalty leviable@50% of tax payable		62,400
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	6,00,000	
(-) Loss assessed under section 143(3)	(2,00,000)	
	8,00,000	
Tax payable on under-reported income@30%	2,40,000	
Add: HEC@4%	9,600	
	2,49,600	
Penalty leviable@50% of tax payable		1,24,800

Note – The applicable rate of tax for Beta Ltd., a trading company, for A.Y.2020-21 is 30%, since its turnover for the P.Y.2017-18 exceeded ₹ 400 crores.

Section B – Additional Questions

Question 13

MCM is a firm liable to tax at the rate of 30% and has filed its return of income. The following information are provided to you:

(i)	Returned Total income	-	₹ 1,00,00,000
(ii)	Total income determined U/s 143(1)(a)	-	₹ 1,20,00,000
(iii)	Total income assessed U/s 143(3)	-	₹ 1,60,00,000
(iv)	Total income reassessed U/s 147	-	₹ 1,90,00,000

Considering that none of the additions or disallowances made in the assessment or re - assessment as above qualifies under section 270A(6), compute the amount of penalty to be levied U/s 270A of the Income-tax Act, 1961 at the time of assessment U/s 143(3) and at the time of reassessment U/s 147 (Assume under-reporting of income is not on account of misreporting).

Answer

MCM, a firm, is deemed to have under-reported its income since:

(1) its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed under section 143(3).

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	1,60,00,000	
(-) Total income determined u/s 143(1)(a)	1,20,00,000	
	40,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 40 lakhs plus on total income of ₹ 120 lakhs determined u/s 143(1)(a) [30% of ₹ 160 lakh + Surcharge@12% +EC @4%]	55,91,040	
Less: Tax on total income determined u/s 143(1)(a) [30% of ₹ 120 lakhs + Surcharge@12% + EC @4%]	41,93,280	
	13,97,760	
Penalty leviable@50% of tax payable		**6,98,880**
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	1,90,00,000	
(-) Total income assessed under section 143(3)	1,60,00,000	
	30,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 30 lakhs plus on total income of ₹ 160 lakhs assessed u/s 143(3) [30% of ₹ 190 lakhs + Surcharge@12% + EC @4%]	66,39,360	
Less: Tax on total income assessed u/s 143(3) [30% of ₹ 160 lakhs + Surcharge@12% + EC @4%]	55,91,040	
	10,48,320	
Penalty leviable@50% of tax payable		**5,24,160**

Question 14

State with reasons the penalty leviable on each of the **four** independent instances:

(1) The premises of A Ltd. was searched and undisclosed income of ₹ 20 crores was determined. The Company did not admit the undisclosed income in a statement under section 132(4) but declared the same in a return furnished, and paid the tax with interest thereon.

(2) M/s ABC Trust an eligible investment fund has filed a statement of its activities for the year ended 31-3-2020 on 31-7-2020.

(3) Meena Caterers has received ₹ 1 lakh in cash and ₹ 9 lakh by account payee crossed cheque from Mr. Arvind for rendering catering services on the occasion of his daughter's wedding.

(4) Mrs. P is a trader who is subject to audit under section 44AB. She has reported cash collections from various Sundry Debtors, but has discovered that she omitted to include 2 more debtors in the statement already filed. She has reported the omission to the authorities within 15 days.

Answer

(1) As per section 271AAB(1A), penalty @60% of undisclosed income would be attracted, since A Ltd. had not admitted the undisclosed income in a statement under section 132(4) but declared the same in a return furnished and paid the tax with interest thereon.

(2) An eligible investment fund, in respect of its activities in a financial year, is required to furnish within 90 days from the end of the financial year (i.e., by 29th of June), a statement of its activities to the prescribed Income-tax authority under section 9A(5).

In the present case, the eligible investment fund has furnished its statement of its activities on 31.7.2020, i.e., after 29th June 2020, being the due date of furnishing such statement, penalty of ₹ 5,00,000 would be attracted under section 271FAB.

(3) No penalty would be leviable on Meena caterers under section 271DA, since it received only ₹ 1 lakh in cash, (which is less than the permissible threshold of ₹ 2 lakhs) in respect of transactions relating to rendering of catering services on the occasion of Mr. Arvind's daughter marriage from Mr. Arvind. The balance ₹ 9 lakh was paid by way of account payee crossed cheque which is a permissible mode of payment.

(4) In this case, Mrs. P, a trader subject to audit under section 44AB, has omitted to include two debtors in the statement of financial transaction filed by her. Even though she has failed to inform and furnish the correct information within 10 days, penalty of ₹ 50,000 is not leviable, since such penalty is attracted only in the case of a prescribed reporting financial institution under section 271FAA(c) read with section 285BA(6).

CHAPTER - 21
Offences and Prosecution

Section A – ICAI Study Material Questions

Question 1

Can prosecution be launched for each of the following actions or defaults committed? If yes, then explain the relevant provisions of the Act and the quantum of prescribed punishment.

(i) The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in the form of electronic record and the books of accounts.

(ii) The assessee deliberately has failed to comply with the requirement of section 142(1) and/or 142(2A).

(iii) The assessee deliberately has failed to make the payment of the tax collected under section 206C.

Answer

(i) Failure to afford facility to the officer authorized as per section 132(1)(iib) is a case for which **prosecution can be launched under section 275B** and such person shall be punishable with rigorous imprisonment **for a term which may extend to two years and shall also be liable to fine.**

(ii) Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A) is a case for which **prosecution can be launched under section 276D** and such person shall be **punishable with rigorous imprisonment for a term which may extend to one year and with fine.**

(iii) Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government is a case for which **prosecution can be launched under section 276BB** and such person shall be **punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.**

Question 2

The Assessing Officer lodged a complaint against M/s. KLM, a firm, under section 276CC of the Income-tax Act, 1961 for failure to furnish its return of income for the A.Y.2018-19 within the due date under section 139(1). The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was ₹ 60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was ₹ 2,900. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not preferred an appeal against it to the Income Tax Appellate Tribunal. The firm desires to know of the maintainability of the prosecution proceedings in the facts and circumstances of the case.

Would your answer change if the person against whom complaint was lodged was KLM Ltd., a company, instead of a firm?

Answer

(i) Section 276CC provides for prosecution for wilful failure to furnish a return of income within

the prescribed time, in a case where tax would have been evaded had the failure not been discovered. Since the amount of tax which would have been evaded does not exceed ₹ 25 lakh, the imprisonment would be for a term of 3 months to 2 years. In addition, fine would also be attracted.

However, in a case where the return of income is not filed within the due date, prosecution proceedings will not be attracted if the tax payable by a person, other than a company, on the total income determined on regular assessment, as reduced by the advance tax, if any, paid and any tax deducted at source, does not exceed ₹ 3,000.

In this case, even though the tax liability of the firm as per the original order of assessment exceeded ₹ 3,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to ₹ 2,900, which is less than ₹ 3,000. Therefore, since the tax liability of the firm on final assessment was determined at ₹ 2,900, the prosecution proceedings are not maintainable.

In Guru Nanak Enterprises v. ITO (2005) 279 ITR 30, where the facts were similar, the Supreme Court held that prosecution was unwarranted.

(ii) Yes, in case of a company, the answer would be different and prosecution proceedings would be maintainable.

Question 3

Explain section 278C applicable in respect of offences committed by Hindu undivided families.

Answer

As per section 278C(1) of the Income-tax Act, 1961, where an offence under the Income-tax Act, 1961 has been committed by a Hindu undivided family (HUF), the karta shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, the karta shall not be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

As per section 278C(2), where an offence under the Income-tax Act, 1961 has been committed by a HUF and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any member of the HUF, such member shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Question 4

Can the Department launch prosecution in a case where they have accepted the revised return filed by the assessee, rectifying a mistake in the original return of income?

Answer

This question came up before the Karnataka High Court in K.E. Sunil Babu, Asst. CIT v. Steel Processors (2006) 286 ITR 315**.** The High Court observed that since the Department had accepted the revised returns filed under section 139(5), it was clear that there was a bona fide mistake in the original return and there was no element of mens rea. Therefore, the High Court held that the Department cannot launch prosecution under sections 276C, 277 and 278.

CHAPTER - 22
Liability in Special Cases

Section A – ICAI Study Material Questions

Question 1

"NEPTUNE" is a shipliner, used in carrying passengers and cargo, owned by M/s Thomas & Thomas of U.K. The ship carried the passengers and cargo in June, 2019 from Singapore to Chennai and vice versa and collected charges thereof amounting to ₹ 200 lacs. It left Chennai port on 15.6.2019 for its journey to Korea. No other journey to India was undertaken by any of the vessels of the company during the year ended on 31.3.2020. The non-resident company had authorized its Indian agent to comply with the income tax provisions.

You are consulted by the company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the Assessing Officer.

Answer

M/s. Thomas & Thomas of U.K shall be required to file the return of income in India for the journey of its ship before it leaves for onward journey to Korea.

However, as per the proviso to section 172(3), where the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return before the departure of the ship from the port, and if satisfactory arrangements have been made for filing of return and payment of tax by the authorised agent in India, he may permit filing of return within 30 days of departure of the ship.

Section 172(4A) provides a time limit of 9 months for completion of assessment in such cases. The period of 9 months is reckoned from the end of the financial year in which the return under section 172(3) is furnished.

Question 2

The directors of a private company are personally liable to pay the income tax due from the company but their liability does not extend towards interest and penalty payable by the company. Discuss.

Answer

Section 179 contains the provisions relating to the liability of directors of a private company in liquidation in respect of tax due from the company. Where any tax due from a private company in respect of income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax. However, the director shall not be so liable if he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Explanation to section 179 clarifies that the expression **"tax due" includes penalty, interest or any other sum payable under the Act.** Therefore, the directors liability is not confined to tax alone but extends to penalty, interest or any other sum payable by the company.

Question 3

In respect of the taxes due from a private limited company, which could not be recovered from it, the Tax Recovery Officer attached the properties of an erstwhile director for recovery thereof. It

was contended by the director that a notice under section 156 had not been served on him and therefore, the proceedings for recovery were not valid. What is the correct legal position?

Answer

The liability of a director of a private limited company for arrears due from the company is provided in section 179. There is no necessity to issue a notice to a director, because the position of a person on whom liability is fastened is equated to that of an 'assessee' in default. For the purpose of section 220(4), the person held liable under section 179 would be deemed to be an assessee- in-default. This may be contrasted with the arrears of a partnership firm which may be recovered from the erstwhile partners only after issue of a notice under section 156 and a default is committed by them.

Under section 179, every person who was a director of a private limited company at any time during the relevant previous year shall be jointly and severally liable for the payment of taxes which cannot be recovered from the company, unless he proves that the non-recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the company.

Section B – Additional Questions

Question 4

There is a tax arrear of ₹ 52 lakhs payable by Super Six Traders (P) Ltd. relating to various assessment years. The court appointed a liquidator on 30-06-2019. The liquidator failed to notify his appointment to the Assessing Officer and also omitted to take note of the tax arrears. He sold some of the assets of the company and settled the suppliers' dues. What would be the legal consequence of the actions of the liquidator?

Answer

As per section 178, the liquidator of Super Six Traders (P) Ltd. has to give notice of his appointment as liquidator within 30 days of his appointment i.e., on or before 30.7.2019 to the Assessing Officer having jurisdiction to assess the income of the company.

He is debarred from parting with the assets of company in his hands until he is notified by the Assessing Officer of the amount of tax arrears (i.e., ₹ 52 lakhs, in this case) except with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

Further, on being so notified, he has to set aside an amount equal to the amount notified.

Since the liquidator has failed to notify the Assessing Officer of his appointment within the time specified and has parted with the assets of the company in his hands in contravention of the above provisions, he shall be personally liable for payment of the tax which the company would be liable to pay.

Failure to comply with the above requirement would be an offence punishable u/s 276A with rigorous imprisonment of two years.

CHAPTER - 23
Miscellaneous Provisions

Section A – ICAI Study Material Questions

Question 1

How does the income of a person who is trying to alienate his assets with a view to avoid tax be dealt with under the Act?

Answer

The income of a person who is trying to alienate his assets with a view to avoid tax will be dealt with as per the provisions of section 175.

Accordingly, if it appears to the Assessing Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of any liability under the Income-tax Act, 1961, the total income of such person for the period from the expiry of the previous year to the date when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

The total income of each completed year or part of any previous year included in such period shall be chargeable to tax at the rates in force in that assessment year and separate assessments will be made for each completed previous year or part of any previous year.

The Assessing Officer may estimate the income of such individual for such period or any part thereof, where it cannot be readily determined in the manner provided in the Act.

The tax chargeable under this section shall be in addition to tax, if any, chargeable under any other provision of the Act.

Question 2

Fearless General Finance & Investment Limited, a residuary non-banking company, accepts public deposits, issues deposit certificate and repays the same after some period of time along with interest, under different schemes run by it. Following transactions were noted from their books of account:

(i) Mr. A, an individual, has deposited ₹ 15,000 on 1st May, 2016 for 48 months by bearer cheque and another ₹ 15,000 on 30th June, 2019 in cash to purchase a new certificate of 48 months tenure.

(ii) Mr. A has applied for premature withdrawal against both the certificates and the company has paid him ₹ 16,500, by a bearer cheque, against principal and interest on 23rd March, 2020, due against his first certificate (purchased in 2016) and ₹ 15,500 in cash on 25th March, 2020, against the second certificate.

Discuss the violation of income tax provision, if any, and consequential penalty for each transaction. Will it make any difference if the certificates were held by Mr. A with his wife Mrs. A, jointly, while repaying back in cash or bearer cheque?

Answer

(i) There is no violation of section 269SS at the time of acceptance of the first deposit of ₹ 15,000 by bearer cheque on 1.5.2016, since it is not in excess of the threshold limit of ₹ 20,000. However, violation under section 269SS is attracted at the time of acceptance of the second deposit in cash on 30th June, 2019, since as on that date, there is already an outstanding

deposit of ₹ 15,000 and another cash deposit of ₹ 15,000 would take the aggregate to ₹ 30,000, which exceeds the threshold limit of ₹ 20,000. Therefore, penalty under section 271D of a sum equal to the amount of deposit taken from Mr. A is attracted for failure to comply with the provisions of section 269SS.

(ii) In this case, there is a violation of the provisions of section 269T at the time of first repayment by bearer cheque on 23rd March, 2020, since on that date, the aggregate amount of deposits held by Mr. A with the non-banking company (together with interest payable on such deposits) is more than ₹ 20,000. Therefore, penalty under section 271E equal to the amount of deposit so repaid will be attracted for failure to comply with the provisions of section 269T.

However, the second repayment of ₹ 15,500 on 25th March, 2020 in cash cannot be considered as a violation of section 269T, since neither the amount of deposit with interest thereon nor the aggregate amount of deposits held by Mr. A on that date together with interest exceeds the threshold limit of ₹ 20,000.

The provisions of section 269T will be attracted at the time of first repayment of bearer cheque even if the certificate is being held by Mr. A in joint name with his wife.

Question 3

The proceedings before the Income-tax Authorities either can be attended by the assessee in person or through an authorized representative. Who can be treated as an authorized representative of the assessee?

Answer

As per section 288, the proceedings before the income-tax authorities can be attended by an assessee in person or through an authorised representative, i.e., a person authorized by the assessee in writing to appear on his behalf, being -

(i) a person who is a relative or a regular employee of the assessee; or

(ii) any officer of a Scheduled Bank in which the assessee maintains a current account or has other regular dealings; or

(iii) a legal practitioner who is entitled to practise in any civil court in India; or

(iv) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 who hold a valid certificate of practice

(v) any person who has passed any accountancy examination recognized in this behalf by the CBDT for this purpose; or

(vi) any person who has acquired such educational qualifications as prescribed by the CBDT; or

(vii) any person who, before the coming into force of this Act in the Union territory of Dadra and Nagar Haveli, Goa, Daman and Diu, or Pondicherry, attended any proceedings before an income-tax authority in the said territory on behalf of any assessee otherwise than in the capacity of an employee or relative of that assessee

(viii) any person who was actually practising as an income-tax practitioner, immediately before commencement of the Income-tax Act, 1961.

Question 4

An order for A.Y. 2018-19 was passed by the Assessing Officer as per section 143(3), but the typist wrongly typed in the order, the assessment year as A.Y.2017-18 and the relevant previous year as ending on 31.3.2017. The assessee claimed in appeal that the same is an invalid order

which was not accepted by the CIT (Appeals) on the ground of the error being of clerical nature. Discuss the correctness of the order of the CIT(Appeals).

Answer

Section 292B provides that no return of income, assessment, notice or summons furnished or made or issued or taken in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment or notice etc., if such return of income, assessment, notice, summons etc. is in substance and effect in conformity with or according to the intent and purpose of the Act. **Therefore, a clerical mistake cannot invalidate an otherwise valid assessment.** Thus, the typographical error in the assessment order as to assessment year and previous year does not make the same invalid unless established otherwise. Accordingly, the action of the CIT(Appeals) in not accepting the claim of the assessee is valid.

Question 5

"Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon." In this context answer:

(i) What are the prescribed modes of service of such notice?

(ii) On whom should the notice be addressed and served upon in the cases where the assessee is a dissolved firm, a deceased person and a partitioned HUF.

Answer

(i) As per section 282(1), the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

(1) by post or such courier services as approved by the CBDT; or

(2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or

(3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or

(4) by any other means of transmission of documents as may be provided by rules made by the CBDT in this behalf.

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(ii) The service of notice in the given cases should be on the persons mentioned hereunder:-

Person	Notice to be addressed and served on
A dissolved firm	Any person who was a partner (not being a minor) immediately before dissolution.
A deceased person	The legal heirs of the deceased.
A partitioned HUF	Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.

Question 6

"Tax Recovery Officer, can recover the arrear demands from the assessee in default out of sale proceeds of the property attached after making a proclamation". How can such proclamation be made under the Act? Is there any time limit for sale of attached immovable property? Discuss.

Answer

Manner of making a proclamation

Movable Property [Rules 38 & 39 of Schedule II to the Income-tax Act, 1961]
Where the Tax Recovery Officer orders sale of movable property, he should issue a proclamation in the language of the district, of the intended sale, specifying the time and place of sale and whether the sale is subject to confirmation or not.

The proclamation should be made by beat of drum or other customary mode, -

(a) in the case of property attached by actual seizure –

  (i) in the village in which the property was seized, or, if the property was seized in a town or city, then, in the locality in which it was seized; and

  (ii) at such other places as the Tax Recovery Officer may direct;

(b) in the case of property attached otherwise than by actual seizure, in such places, if any, as the Tax Recovery Officer may direct.

A copy of the proclamation should also be affixed in a conspicuous part of the office of the Tax Recovery Officer.

Immovable Property [Rule 54 of Schedule II to the Income-tax Act, 1961]
The Tax Recovery Officer shall make a proclamation for sale of immovable property at some place on or near such property by beat of drum or other customary mode. A copy of the proclamation shall be affixed on a conspicuous part of the property and also upon a conspicuous part of the office of the Tax Recovery Officer.

Where the Tax Recovery Officer directs, such proclamation shall also be published in the Official Gazette or in a local newspaper or in both, and the cost of such publication shall be deemed to be cost of the sale.

Where the property to be sold is divided into lots for the purpose of being sold separately, then it is not necessary to make a separate proclamation for each lot of property, unless in the opinion of the Tax Recovery Officer, proper notice of sale cannot otherwise be given.

Time limit for sale of attached immovable property [Rule 68B of Schedule II to the Income-tax Act, 1961]

The sale of immovable property attached has to be made on or before the expiry of 7 years from the end of the financial year in which the order giving rise to a demand of any tax, interest, fine, penalty or any other sum, for the recovery of which the immovable property has been attached,

- has become conclusive under the provisions of section 245-I (where order of settlement under section 245D(4) is deemed to be conclusive as to the matters stated therein) or
- has become final in terms of the provisions of Chapter XX (Appeals and Revision).

However, the CBDT may, for reasons to be recorded in writing, extend the aforesaid period for a further period not exceeding 3 years.

Question 7

Explain the circumstances under which the Assessing Officer can resort to provisional attachment of the property of the assessee. Also, state the period of time for which such attachment can take place.
When can the Assessing Officer revoke provisional assessment of property? Discuss.

Answer

As per the provisions of section 281B, there can be provisional attachment to protect the interest of Revenue in certain cases i.e.-

(i) The proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment should be pending.

(ii) Such attachment should be necessary for the purpose of protecting the interest of Revenue in the opinion of the Assessing Officer.

(iii) The previous approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director has been obtained by the Assessing Officer.

(iv) The Assessing Officer, may, by an order in writing attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.

(v) Such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of order made under section 281B(1). However, the period can be extended by the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director, as the case may be, for the reasons to be recorded in writing for a further period or periods as he thinks fit. The total period of extension in any case cannot exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

The Assessing Officer shall, by order in writing, revoke provisional attachment of a property made under section 281B(1) in a case where the assesse furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

Question 8

Mr. Biswas, a stock broker, has defaulted with regard to his income-tax payments and the Assessing Officer has attached his membership card of Stock Exchange under section 281B of the Income-tax Act, 1961. Mr. Biswas contends that the membership card is not transferable and is not his personal asset. Discuss the validity of attachment of the card by the Assessing Officer in the context of Section 281B.

Answer

The right of membership is not a private asset and it is merely a personal privilege granted to the member. It is non-transferable and incapable of alienation by the member or his legal representative except to the limited extent provided in the rules and regulations of the stock exchange and subject to the fulfillment of conditions prescribed by the stock exchange. The nomination, even if permitted, is subject to the rules and is not automatic. The right of nomination is vested in the stock exchange absolutely in the case of death of or default of a member. Thus, the membership card is not the property of the assessee and therefore cannot be attached under section 281B. It has been so held by the Apex Court in the case of Stock Exchange Ahmedabad vs. ACIT (2001) 248 ITR 209.

Section B – Additional Questions

Question 9

The regular assessment of Ms. Swati for the A.Y. 2016-17 was completed u/s 143(3) on 16-07-2018. On 18-01-2020, she received a notice issued u/s 148 for income escaping assessment for the same A.Y. 2016-17. Further, on 25-03-2020, during the pendency of such proceeding for income escaping assessment, the A.O. attaches the house property of Ms. Swati.

Now, aggrieved Swati seeks your opinion (being a Chartered Accountant) as to:

(i) The circumstances under which the A.O. can make provisional attachment of property of the assessee.

(ii) The period of time for which such attachment can take place.

(iii) Can such attachment be revoked by the A.O. and if yes, how?

Discuss the relevant provisions of law to satisfy the aggrieved assessee, Ms. Swati.

Answer

(i) As per section 281B(1), the Assessing Officer is empowered to provisionally attach any property of Ms. Swati, by an order in writing, during the pendency of assessment or reassessment proceedings, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner or Principal Director General or Director General or Principal Director or Director, if he is of the opinion that it is necessary to do so for the purpose of protecting the interests of the revenue.

(ii) As per section 281B(2), the provisional attachment shall be valid for a period of 6 months from the date of the order issued for provisional attachment.

However, the income-tax authority may extend the period of provisional attachment, for reasons to be recorded in writing, by a further period as he thinks fit.

However, the total period of extension shall not exceed two years or sixty days after the date of assessment or reassessment, whichever is later.

(iii) Section 281B(3) empowers the Assessing Officer to revoke, by an order in writing, provisional attachment of property if Ms. Swati furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

Question 10

Mr. B proposes to purchase for his business, certain raw materials from Mr. S. In view of the scarcity of the products, S insists on cash payments for the purchases, to which B agrees. On 27-3-2020, the purchases are effected through a cash invoice for ₹ 3,20,000.

In respect of the above transactions, will there be any detrimental effect in the hands of B and S under the provisions of the Income-tax Act, 1961? Explain briefly.

Will your answer be different, if the cash purchases are effected by the buyer B on two different dates for different raw materials for ₹ 1,80,000 and ₹ 1,40,000 respectively?

Answer

(1) Where purchases are effected through cash invoice of ₹ 3,20,000

(i) In the hands of Mr. B

Since Mr. B is making cash payment of ₹ 3,20,000 for purchase of raw materials from Mr. S for his business, disallowance under section 40A(3) would be attracted, since the

payment otherwise than by way of account payee cheque or bank draft or use of ECS through a bank account to a person in a day exceeds ₹ 10,000. Accordingly, ₹ 3,20,000 would not be allowable as deduction while computing his business income.

(ii) In the hands of Mr. S

Section 269ST prohibits, inter alia, receipt of an amount of ₹ 2 lakh or more in aggregate from a person in a day otherwise than by way of account payee cheque or account payee bank draft or use of ECS through a bank account. If any person receives any sum in contravention of the provisions of section 269ST, he shall be liable to pay penalty under section 271DA of a sum equal to the amount of such receipt.

In this case, since S has received ₹ 3,20,000 by way of cash from Mr. B on 27.3.2020, he has violated the provisions of section 269ST, and hence, is liable to pay penalty of ₹ 3,20,000 under section 271DA.

(2) Where cash purchases of ₹ 1,80,000 and ₹ 1,40,000 are effected in respect of different raw materials on two different dates

(i) <u>In the hands of Mr. B</u>

Even if cash payment of ₹ 1,80,000 and ₹ 1,40,000 are made by Mr. B on two different dates for different raw materials, disallowance under section 40A(3) would be attracted, since the payment in cash in a day to Mr. S exceeds ₹10,000.

(ii) <u>In the hands of Mr. S</u>

If S receives cash of ₹ 1,80,000 and ₹ 1,40,000 on two different dates, for purchase of different raw materials, there would be no violation of section 269ST since receipt on a day is less than ₹ 2 lakh and the receipts are not in respect of the same transaction but for purchase of different raw materials. Hence, provision of section 271DA shall not be attracted.

Question 11

Mr. Srinivasan was a Central Government pensioner, who expired on 10-5-2020. An amount of ₹ 10 lakhs in cash was deposited into his savings bank account maintained in a nationalized bank on 28-2-2020, which was reported by the banker u/s 285BA. A notice was issued by the Assessing Officer to Mrs. Srinivasan who is his legal representative to file his Return of Income. Mrs. Srinivasan has approached you as a Tax Consultant as to the course of action to be undertaken by her, since she is unaware of her deceased husband's financial dealings.
What will be your advice to Mrs. Srinivasan?

Answer

The advice to Mrs. Srinivasan would be on the following lines –

Mrs. Srinivasan, the legal representative of Mr. Srinivasan, would be deemed to be an assessee for the purpose of the Income-tax Act, 1961. Mrs. Srinivasan would be liable to file return of income as a legal representative and pay any sum which Mr. Srinivasan would have been liable to pay if he had not died, in the like manner and to the same extent as the deceased. Any sum includes tax, penalties, interest or any other sum that would have been payable by her deceased husband. The liability of Mrs. Srinivasan would be limited to the extent to which, the estate of the deceased is capable of meeting the liability. No prosecution can, however, be initiated on Mrs. Srinivasan for any offence committed by her deceased husband.

CHAPTER - 1
Transfer Pricing

Section A – ICAI Study Material Questions

Question 1

Examine the consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer

In case the Assessing Officer makes adjustment to arm's length price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:-

(1) No deduction under section 10AA or Chapter VI-A shall be allowed from the income so increased.

(2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

(1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.

(2) In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.

(3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 2

I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2019-20. I. Limited also supplied the same product to another UK based company,

V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited.

Answer

In this case, I. Limited, the Indian company, supplied billets to its foreign holding company, U. Limited. Since the foreign company, U. Limited, is the holding company of I. Limited, I. Limited and U. Limited are the associated enterprises within the meaning of section 92A.

As I. Limited supplies similar product to an unrelated entity, V. Limited, UK, the transactions between I. Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between I. Limited and U. Limited Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with U. Limited are on FOB basis, whereas transactions with V. Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

	Amount (in Euro)
Price per MT of billets to V. Limited	700
Less: Cost of insurance and freight per M.T.	200
Adjusted Price per M.T.	500

Since the adjusted price for V. Limited, UK and the price fixed for U. Limited are the same, the arm's length price is Euro 500 per MT. Since the sale price to related party (i.e., U. Limited) and unrelated party (i.e., V. Limited) is the same, the transaction with related party U. Limited has also been carried out at arm's length price.

Question 3

X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of international transactions of ₹ 300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of ₹ 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.

Answer

The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds 55% shares of X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of "international transaction" under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm's length price.

The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

(i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X applies, would attract penalty @ 200% of the amount of tax payable since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

(ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of

the value of each international transaction.

(iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of ₹ 1 Lac.

The Assessing Officer shall give an opportunity of hearing to the assessee with a notice as to why the arm's length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

Note: It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.

Question 4

Anush Motors Ltd., an Indian company declared income of ₹ 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2020:

(i) 10,000 cars sold to Rida Ltd., US company, which holds 30% shares in Anush Motors Ltd. at a price which is less by $ 200 each car than the price charged from Shingto Ltd.

(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd., a US company, for use of technical know- how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000.

(iii) Loan of Euro 1000 crores carrying interest @10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2020. The total book value of assets of Anush Motors Ltd. on the date was ₹ 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2020-21 keeping in mind that the value of 1$ and of 1 EURO was ₹ 63 and ₹ 84, respectively, throughout the year.

Answer

Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that "Anush Motors Ltd." is associated with :-

(i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

(ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2020-21.

	Particulars	₹

Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		300.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ $ 200 each for 10,000 cars ($ 200 x 10,000 x ₹ 63)	12.60
(ii)	Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 x ₹ 63) [See Note below]	18.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (₹ 84*1000*1/100)	840.00
Total Income		**1,171.50**

The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

Note: It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.

Question 5

What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions? Examine.

Answer

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing.

There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

Question 6

R, an individual resident in India, bought 1,000 equity shares of ₹ 10 each of A Ltd. at ₹ 50 per share on 30.5.2019. He sold 700 equity shares at ₹ 35 per share on 30.9.2019 and the remaining 300 shares at ₹ 25 per share on 20.12.2019. A Ltd. declared a dividend of 50%, the record date being 10.8.2019. R sold on 1.2.2020, a house from which he derived a long-term capital gain of ₹ 75,000.
Compute the amount of capital gain arising to R for the assessment year 2020-21.

Answer

The amount of capital gains arising to R has to be computed applying the provisions of section 94(7), which provides that where:

(a) any person buys or acquires any securities or unit within a period of three months prior to the record date; and

(b) such person sells or transfers -
  (i) such securities within a period of three months after such date; or
  (ii) such unit within a period of nine months after such date; and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purpose of computing his income chargeable to tax".

For this purpose, "record date" means such date as may be fixed by a company for the purpose of entitlement of the holder of the securities to receive dividend; "securities" includes stocks and shares.

Computation of capital gains of Mr. R for the assessment year 2020-21

Particulars	₹	₹
Long-term capital gain on sale of building		75,000
Less: Short-term capital loss on sale of shares		
700 shares	7,000	
300 shares	7,500	14,500
Taxable long-term capital gains		**60,500**

Computation of capital gain on sale of shares of A Ltd. by Mr. R

Date of purchase of shares		30.5.2019
Record date		10.8.2019
Date of sale of shares	30.9.2019	20.12.2019
Number of shares sold	700	300
Sale price per share	₹ 35	₹ 25

Particulars	₹	₹
Sale consideration	24,500	7,500
Less: Cost of acquisition	35,000	15,000
	10,500	7,500
Less: Dividend income as per section 94(7)[700×₹10×50%] [See Note below]	3,500	-
Short-term capital loss on sale of shares	**7,000**	**7,500**

Note:

(1) 700 shares are sold within 3 months after the record date. Hence, as per section 94(7), the related dividend income should be deducted from the loss.

(2) 300 shares having been sold after 3 months of record date, section 94(7) is not attracted. Therefore, the dividend income of ₹ 1,500 [300×₹10×50%] should not be deducted. Such dividend is exempt under section 10(34).

(3) Short-term capital loss can be set-off against long-term capital gains as per the provisions of section 74(1)(a). Therefore, short-term capital loss on sale of shares can be set-off against long-term capital gains on sale of building.

Question 7

XE Ltd. is an Indian Company in which Zilla Inc., a US company, has 28% shareholding and voting power. Following transactions were effected between these two companies during the financial year 2019-20.

(i) XE Ltd. sold 1,00,000 pieces of T-shirts at $ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc., at $ 3 per T-Shirt.

(ii) XE Ltd. borrowed $ 2,00,000 from a foreign lender based on the guarantee of Zilla Inc. For this, XE Ltd. paid $ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected $ 7000 as guarantee fee.

(iii) XE Ltd. paid $15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for $ 10,000.

Assume the rate of exchange as 1 $ = ₹ 64

XE Ltd. is located in a Special Economic (SEZ) and its income before transfer pricing adjustments for the year ended 31st March, 2020 was ₹ 1,200 lakhs.

Compute the adjustments to be made to the total income of XE Ltd. Assuming that such adjustments are made by the Assessing Officer, state whether it can claim deduction under section 10AA for the income enhanced by applying transfer pricing provisions.

Answer

XE Ltd, the Indian company and Zilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Zilla Inc. holds shares carrying not less than 26% of the voting power in XE Ltd.

As per Explanation to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price. In this case, from the information given, the arm's length price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

Particulars		₹ in lakhs
Amount by which total income of XE Ltd. is enhanced on account of adjustment in the value of international transactions:		
(i)	Difference in price of T-Shirt @ $ 1 each for 1,00,000 pieces sold to Zilla Inc. ($ 1 x 1,00,000 x ₹ 64)	64.00
(ii)	Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender ($ 3,000 x ₹ 64)	1.92
(iii)	Difference for excess payment for services to Zilla Inc. ($ 5,000 x ₹ 64)	3.20
		69.12
XE Ltd. cannot claim deduction under section 10AA in respect of ₹ 69.12 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4)		

Question 8

Examine the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961

(i) Transfer pricing rules shall have no implication where income is computed on the basis of book profits.

(ii) Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee.

Answer

(i) The statement is correct.

For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the statement of profit and loss prepared in accordance with the Companies Act can be increased/ decreased only by the additions and deductions specified in Explanation 1 below section 115JB(2).

No other adjustments can be made to arrive at the book profit for levy of MAT, except where:

(a) it is discovered that the statement of profit and loss is not drawn up in accordance with the relevant Schedule of the Companies Act

(b) incorrect accounting policies and/or accounting standards have been adopted for preparing such accounts; and

(c) the method and rate of depreciation adopted is not correct.

Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

(ii) The statement is not correct.

Section 92CA(4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm's length price of an international transaction, the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.

Question 9

A Ltd., an Indian company, provides technical services to a company, XYZ Inc., located in a NJA for a consideration of ₹ 40 lakhs in October, 2019. It charges ₹ 42 lakhs for similar services rendered to PQR Inc., which is not located in a NJA. PQR Inc. is not an associated enterprise of A Ltd.

Discuss the tax implications under section 94A read with section 92C in respect of the above transaction of provision of technical services by A Ltd. to XYZ Inc.

Answer

Since XYZ Inc. is located in a NJA, the transaction of provision of technical services by the Indian company, A Ltd., would be deemed to be an international transaction and XYZ Inc. and A Ltd.

would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The price of ₹ 42 lakhs charged for similar services from PQR Inc, being an independent entity located in a non-NJA country, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since the ALP is more than the transfer price, the ALP of ₹ 42 lakhs would be considered as the income arising from the international transaction between A Ltd. and XYZ Inc.

It may be noted that the benefit of permissible variation between the ALP and transfer price is not available in respect of a transaction entered into with an entity in NJA.

Question 10

Mr. X, a non-resident individual, is due to receive interest of ₹ 5 lakhs during March 2020 from a notified infrastructure debt fund eligible for exemption under section 10(47). He incurred expenditure amounting to ₹ 10,000 for earning such income. Assuming that Mr. X is a resident of a NJA, discuss the tax implications under section 94A, read with sections 115A and 194LB.

Answer

The interest income received by Mr. X, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 115A on the gross amount of such interest income. Therefore, the tax liability of Mr. X in respect of such income would be ₹ 26,000 (being 5% of ₹ 5 lakhs plus health and education cess@4%).

Under section 194LB, tax is deductible @5% (plus health and education cess@4%) on interest paid by such fund to a non-resident. However, since X is a resident of a NJA, tax would be deductible@30% (plus health and education cess@4%) as per section 94A, and not @5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that "**Notwithstanding anything contained in any other provision of this Act,** where a person located in a NJA is entitled to receive any sum or income or amount on which **tax is deductible under Chapter XVII-B,** the **tax shall be deducted at the highest of the following rates**, namely–

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provision of the Act;

(c) at the rate of thirty per cent."

Mr. X can, however, claim refund of excess tax deducted along with interest.

Section B – Additional Questions

Question 11

Examine whether transfer pricing provisions under the Income-tax Act, 1961 would be attracted in respect of the following cases -

(i) Scientific research services provided by Lambda Sicom, an Italian company to XYZ Ltd., an Indian company. Lambda Sicom is a "specified foreign company" as defined in section 115BBD, in relation to XYZ Ltd.

(ii) Purchase of commodities by Omega Ltd., an Indian company, from Cylo AG, a German company. Omega Ltd. is the subsidiary of Cylo AG.

(iii) EF Ltd., an Indian company, has two units, E & F. Unit E, which commenced business two years back, is engaged in the development of a highway project, for which purpose an agreement has been entered into with the Central Government. Unit F is carrying on the business of trading in steel. Unit F transfers 20,000 metric tons of steel of the value of ₹ 32,000 per MT to Unit E for ₹ 20,000 per MT.

(iv) Transfer of technical knowhow by Y Ltd., an Indian company, to Alcatel Lucent, a French company, which guarantees 15% of the borrowings of Y Ltd.

Answer

(i) Clause (i) of Explanation to section 92B amplifies the scope of the term "international transaction". According to the said Explanation, international transaction includes, inter alia, provision of scientific research services. Lambda Sicom is a specified foreign company in relation to XYZ Ltd. Therefore, the condition of XYZ Ltd. holding shares carrying not less than 26% of the voting power in Lambda Sicom is satisfied, assuming that all shares carry equal voting rights. Hence, Lambda Inc. and XYZ Ltd. are deemed to be associated enterprises under section 92A(2). Since the provision of scientific research services by Lambda Sicom to XYZ Ltd. is an "international transaction" between associated enterprises, transfer pricing provisions are attracted in this case.

(ii) Purchase of tangible property falls within the scope of "international transaction". Tangible property includes commodity. Cylo AG and Omega Ltd. are associated enterprises under section 92A, since Cylo AG is a holding company of Omega Ltd.. Therefore, purchase of commodities by Omega Ltd., an Indian company, from Cylo AG, a German company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

(iii) Unit E is eligible for deduction@100% of the profits derived from its eligible business (i.e., the business of developing an infrastructure facility, namely, a highway project in this case) under section 80-IA. However, Unit F is not engaged in any "eligible business". Since Unit F has transferred steel to Unit E at a price lower than the fair market value, it is an inter-unit transfer of goods between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods. Therefore, this transaction would fall within the meaning of "specified domestic transaction" to attract transfer pricing provisions, since the aggregate value of such transactions during the year exceeds ₹ 20 crore.

(iv) The scope of the term "intangible property" has been amplified to include, inter alia, technical knowhow, which is a technology related intangible asset. Transfer of intangible property falls within the scope of the term "international transaction". Since Alcatel Lucent, a French company, guarantees not less than 10% of the borrowings of Y Ltd., an Indian company, Alcatel Lucent and Y Ltd. are deemed to be associated enterprises under section 92A(2). Therefore, since transfer of technical knowhow by Y Ltd., an Indian company, to Alcatel Lucent, a French company, is an international transaction between associated enterprises, the provisions of transfer pricing are attracted in this case.

Question 12

NANO Inc., a German Company, holds 45% of equity in Hitech Ltd., an Indian Company. Hitech Ltd. is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes NANO Inc.

During the financial year 2019-20, Hitech Ltd. had spent 2400 man hours for developing and maintaining software for NANO Inc. with each hour being billed at Rs. 1,300. Cost incurred by Hitech Ltd. for executing work for NANO Inc. amounts to Rs. 20 lakhs.

Hitech Ltd. had also undertaken developing software for Modi Industries, for which Hitech Ltd. had billed at Rs. 2,700 per man hour. The persons working for Modi Industries and NANO Inc. were part of the same team and were of matching credentials and calibre. Hitech Ltd. made a gross profit of 60% on Modi Industries work. Hitech Ltd.'s transactions with NANO Inc. are comparable to transactions with Modi Industries, subject to the following differences:

(i) NANO Inc. gives technical knowhow support to Hitech Ltd., which can be valued at 8% of the normal gross profit. Modi Industries does not provide any such support.

(ii) Since the work for NANO Inc. involved huge number of man hours, a quantity discount of 14% of normal gross profits was given.

(iii) Hitech Ltd. had offered 90 days credit to NANO Inc., the cost of which is measured at 2% of the normal billing rate. No such discount was offered to Modi Industries.

Compute arm's length price as per cost plus method and the amount of increase in total income of Hitech Ltd.

Answer

Computation of Arm's Length Price as per Cost Plus Method

Particulars		Rs.
Gross Profit Mark up in case of Modi Industries **[an unrelated party]**	60.0%	
Less: Differences to be adjusted		
- Value of technical know-how (8% of 60%)	4.8%	
- Quantity discount to Nano Inc. (14% of 60%)	8.4%	
	46.8%	
Add: Cost of credit to Nano Inc., **an associated enterprise** (2% of 100%)	2.0%	
Arm's length gross profit mark up	**48.8%**	
Cost incurred by Hitech Ltd. for executing Nano Inc's work. [100% - 48.8%= 51.2%]		20,00,000
Add: Adjusted gross profit (Rs. 20,00,000 x 48.8/51.2)		19,06,250
Arm's length billed value		**39,06,250**
Less: Actual Billed Income in the case of Nano Inc (Rs. 1300 x 2400 man hours)		31,20,000
Total Income of Hitech Ltd to be increased by		**7,86,250**

Question 13

Amar P Ltd., Bangalore is engaged in IT Enabled services. It is the subsidiary of ABC Inc in US. It also provides similar services to a company SAK Ltd. at Singapore. Its billings and other information is as given hereunder:

(i) Billings per month to ABC Inc. - USD 85000

(ii) Billings per month to SAK Ltd. - USD 70000

(iii) ABC Inc has provided a loan of USD 100000 to Amar P Ltd. towards purchase of hardware for executing its project. Rate of interest charged for the said loan is at 3% p.a.

(iv) Direct and indirect cost incurred are USD 100 and USD 200 per hour, respectively.

(v) Amar P Ltd. works 9 hours per day for 15 days to execute the projects for ABC Inc and 8 hours per day for 15 days to execute projects for SAK Ltd. Service was provided by the company to both its customers throughout the year.

(vi) Warranty was provided to SAK Ltd. for a period of 2 years. Cost of warranty is calculated at 1% of direct cost incurred. The cost of warranty is neither included in the direct nor indirect cost.

Assume conversion rate 1 USD = ₹ 64. Compute Arm's Length Price as per the cost-plus method and the amount to be added, if any, to the income of Amar P Ltd.

Answer

Determination of Gross Margin of Comparable Uncontrolled transaction i.e., of SAK Ltd.

Particulars	Amt in USD
Direct Cost (USD 100 x 8 hours x 15 days)	12,000
Indirect Cost (USD 200 x 8 hours x 15 days)	24,000
Total Direct and Indirect cost	**36,000**
Billing per month	70,000
Gross Margin being gross profit	**34,000**
Gross Margin to cost (%) [34,000 x 100/36,000]	**94.44%**
Adjustment for functional difference of cost of warranty	
Total Direct and Indirect Cost	36,000
Add: Cost of warranty [1% of direct cost of USD 12,000]	120
Total Cost	**36,120**
Billing per month	70,000
Margin after cost of warranty being profit margin [70,000 - 36,120]	**33,880**
Profit margin to cost (%) [after considering functional difference on account of cost of warranty [33,880 x 100/36,120]	**93.80%**

Computation of Arm's Length Price by applying Cost Plus Method

	ABC Inc (USD)
Direct Cost (USD 100 x 9 hours x 15 days)	13,500
Indirect Cost (USD 200 x 9 hours x 15 days)	27,000
Total Direct and Indirect cost	**40,500**
Add: Interest on loan of USD 1,00,000 borrowed for purchase of hardware [USD 3,000 (i.e., USD 1,00,000@3%) / 12]	250
Total Cost	40,750
Profit by applying margin of 93.80% of total cost of USD 40,750	38,224
Arm's length price of billing per month	**78,974**
Arm's length price (in ₹) [USD 78,974 x 64] = ₹ 50,54,336	
Actual Billing per month	85,000

Since actual billing of USD 85,000 per month to the ABC Inc, an AE, is higher than Arm's length price of USD 78,974 determined by cost plus method, no adjustment is to be made to the income of Amar P Ltd.

Question 14

Answer the following in the context of international transactions:

(i) Company X and Company Y who entered into Advance Pricing Agreements (APA) and eligible for rollback provisions merged to form Company XY. Is the Company XY eligible for rollback provisions as it was formed on merger of Company X and Company Y?

(ii) Proceedings before the TPO were stayed by court order and it was subsequently lifted. The time limit for completion of assessment after excluding the period of stay due to court order is only 30 days. Within how many more days, the TPO has to pass his order?

(iii) The gross total income of Sachin Co. Ltd., Pune was Rs. 70 lakhs which is wholly attributable to a unit located in SEZ since April, 2012. Adjustments to total income made by the Assessing Officer by applying the transfer pricing provisions, enhanced the total income by Rs. 50 lakhs. What is the total income chargeable to tax and explain why?

Answer

<table>
<tr><th></th><th colspan="2">Particulars</th></tr>
<tr><td>(i)</td><td colspan="2">The agreement of APA is between the Board and a taxpayer/person. The principle to be followed is that the person who makes the APA application alone would be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years.
Since Company X and Y were the APA applicants and not the new company XY formed as a result of merger, Company XY would not be eligible for the rollback provisions.</td></tr>
<tr><td>(ii)</td><td colspan="2">As per the proviso to section 92CA(3A), where assessment proceedings are stayed by any Court and the time available to the Transfer Pricing Officer for making an order is less than 60 days, then, such remaining period shall be extended to 60 days.
In the present case, since only 30 days is available after excluding the period of stay, the same will be extended by 30 days and TPO can make an order within 60 days.</td></tr>
<tr><td>(iii)</td><td colspan="2">As per the proviso to section 92C(4), where the arm's length price is determined by the Assessing Officer by applying transfer pricing provisions, no deduction, inter alia, under section 10AA shall be allowed from the income so enhanced by the Assessing Officer.</td></tr>
<tr><td></td><td colspan="2">Assuming that the entire turnover represents the export turnover, and consequently, the entire profit of Rs. 70 lakhs is eligible for deduction under section 10AA, the total income would be computed as follows:
<table>
<tr><th>Particulars</th><th>in lakhs</th></tr>
<tr><td>Income of unit in SEZ (computed)</td><td>70</td></tr>
<tr><td>Less: Deduction u/s 10AA = 50% of Rs. 70 lakhs, being the 7th year</td><td>35</td></tr>
<tr><td></td><td>35</td></tr>
<tr><td>Add: Enhancement in total income by the Assessing Officer, applying transfer pricing provisions.</td><td>50</td></tr>
<tr><td>Total Income</td><td>85</td></tr>
<tr><td>[No deduction u/s 10AA is allowable in respect of income so enhanced]</td><td></td></tr>
</table></td></tr>
</table>

Question 15

X Ltd., a resident Indian Company, on 01-04-2019 has borrowed ₹ 100 crores from A Inc, a Company incorporated in US, at an interest rate of 9 % p.a. The said loan is repayable over a period of 10 years. Further, loan is guaranteed by B Inc incorporated in US. K Inc, a non-resident, holds shares carrying 30% of voting power both in X Ltd. and B Inc. K Inc has also deposited ₹ 100 crores with A Inc.

Other information

Net profit of X Ltd. was ₹ 10 crores after debiting the above interest, depreciation of ₹ 5 crores and income-tax of ₹ 3.40 crores. Calculate the interest to be disallowed under the head "Profits and gains of business or profession" in the computation of X Ltd.

Answer

If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds ₹ 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its EBITDA or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 94B.

Further, where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to be issued by an associated enterprise and limitation of interest deduction would be applicable.

In the present case, since K Inc holds 30% of voting power i.e., more than 26% of voting power in both X Ltd and B Inc, X Ltd. and B Inc are associated enterprises.

Since loan of ₹ 100 crores taken by X Ltd., an Indian company from A Inc, is guaranteed by B Inc, an associated enterprise of X Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to A Inc shall be considered for the purpose of limitation of interest deduction under section 94B.

Computation of interest to be disallowed as per section 94B in the computation of income under the head profits and gains of business or profession of X Ltd.

Particulars		₹
Net profit		10,00,00,000
Add: Interest already debited (₹ 100 crores x 9%)		9,00,00,000
Depreciation		5,00,00,000
Income tax		3,40,00,000
EBITDA		**27,40,00,000**
Interest paid or payable by X Ltd.		9,00,00,000
Interest paid or payable in excess of lower of following disallowed		
- 30% of EBITDA	₹ 8,22,00,000	
- Interest paid or payable to non-resident AE	₹ 9,00,00,000	8,22,00,000
Interest to be disallowed as deduction		**78,00,000**

Question 16

Konark Digital Solutions Ltd. is an Indian Company in which Yokohoma Inc., a Singapore based company holds 30% shareholding and voting power. During the previous year 2018-19, the Indian company supplied laptops to the Singapore based company @ $ 800 per piece. The price of laptop supplied to other unrelated parties in Singapore is @ $ 1200 per piece. During the course of

assessment proceedings, the AO carried out primary adjustments and added a sum of ₹ 130 lakhs, being the difference between actual price of laptop and arm's length price for 500 pieces and it was duly accepted by the assessee. On account of this adjustment, the excess money of ₹ 130 lakhs is available with Yokohoma Inc, Singapore. In this context, you are requested to briefly explain the relevant provisions of Income-tax Act, 1961 and suggest suitable solution for the following issues:

(i) What is the effect of this transaction on the taxable income of Konark Digital Solutions Ltd. for the assessment year 2020-21 on the basis that it declared an income of ₹ 250 lakhs and the excess money is still lying with Yokohoma Inc. till today?

Assume the rate of exchange as 1 $ = ₹ 65 and the marginal cost of lending rate of SBI as on 01.04.2019 at 10.75%.

(ii) Would taxable income of Konark Digital Solutions Ltd. undergo any change, if the above adjustment carried out resulted in addition of ₹ 90 lakhs as against ₹ 130 lakhs?

(iii) What is the impact of this adjustment on taxable income of Konark Digital Solutions Ltd. for assessment year 2020-21, if such adjustment pertains to the previous year 2015-16 as against 2018-19?

Answer

(i) On account of the primary adjustment of ₹ 130 lakhs made by the Assessing Officer, the total income of Konark Digital Solutions Ltd. for A.Y.2019-20 would increase by ₹ 130 lakhs. In this case, secondary adjustment has to be made since –

(1) The company has accepted the primary adjustment made by the Assessing Officer;
(2) The primary adjustment is in respect of A.Y.2019-20; and
(3) The primary adjustment exceeds ₹100 lakhs.

Accordingly, the excess money (i.e., ₹130 lakhs) available with the associated enterprise (i.e., Yokohoma Inc., Singapore) not repatriated to India within 90 days of the date of the order of the Assessing Officer would be deemed as an advance made by the Konark Digital Solutions Ltd. to its associated enterprise, Yokohoma Inc. Interest would be calculated on such advance at the rate of six month LIBOR as on 30th September + 3%, since the international transaction is denominated in $. Such interest, if any, for the P.Y.2019-20 would be added to his total income of ₹250 lakhs for A.Y.2020-21.

In order to avoid this tax implication, the excess money (i.e., ₹130 lakhs) available with the associated enterprise (i.e., Yokohoma Inc., Singapore) must be repatriated to India within 90 days of the date of the order of the Assessing Officer.

(ii) Since secondary adjustment in the books of account is not required if the primary adjustment does not exceed ₹ 100 lakhs, no secondary adjustment needs to be made in the books of account if the primary adjustment for A.Y.2019-20 is only ₹ 90 lakhs. The total income for A.Y.2020-21 would, therefore, be only ₹ 250 lakhs.

(iii) Secondary adjustment in the books of account is not required where the primary adjustment is made in respect of A.Y.2016-17 (relevant to P.Y.2015-16) or any earlier assessment year. Therefore, there would be no impact of this adjustment on the taxable income of the company if primary adjustment pertains to P.Y. 2015-16. The taxable income would remain at ₹ 250 lakhs.

Question 17

State with reasons, whether Netlon LLC., (Incorporated in Singapore) and Briggs Ltd., a domestic company, are/can be deemed to be associated enterprises for the transfer pricing regulations (Each situation is independent) of the others:

(i) Netlon LLC. has advanced a loan of ₹ 53 crores to Briggs Ltd. on 12-1-2020. The total book value of assets of Briggs Ltd. is ₹ 100 crores. The market value of the assets, however, is ₹ 150 crores. Briggs Ltd. repaid ₹ 10 crores before 31-3-2020.

(ii) Netlon LLC. has the power to appoint 2 of the directors of Briggs Ltd, whose total number of directors in the Board is 4.

(iii) Total value of raw materials and consumables of Briggs Ltd. is ₹ 900 crores. Of this, Netlon LLC. supplies to the tune of ₹ 820 crores, at prices mutually agreed upon once in six months and depending upon the market conditions.

Answer

(i) Netlon LLC, a foreign company, has advanced loan of ₹ 53 crores to Briggs Ltd., a domestic company, which amounts to 53% of book value of assets of Briggs Ltd. Since the loan advanced by Netlon Inc. is not less than 51% of the book value of assets of Briggs Ltd., Netlon Inc. and Briggs Ltd. are deemed to be associated enterprises for the transfer pricing regulations.

The deeming provisions would be attracted even if there is a repayment of loan during the same previous year which brings down his percentage below 51%.

(ii) Netlon LLC has the power to appoint 50% (2 out of 4) of the directors of Briggs Ltd.

Two enterprises would be deemed to be associated enterprises if more than half of the board of directors of one enterprise are appointed by the other enterprise.

In this case, since Netlon LLC has the power to appoint exactly half (and not more than half) of the directors of Briggs Ltd., they are not deemed to be associated enterprises.

(iii) Even though Netlon LLC supplies 91.11% of the raw materials and consumables required by Briggs Ltd. which is more than the specified threshold of 90%, Netlon LLC and Briggs Ltd. are not deemed to be associated enterprises

Reason for not deemed to be associated enterprises is since the price of supply is not influenced by Netlon LLC but is mutually agreed upon once in six months depending upon prevailing market conditions.

Question 18

Muskaan Ltd. (MK India) is an Indian company that manufactures cricket kits in India. MK India is eligible for deduction under section 10AA of the Income-tax Act, 1961. For its UK sales, MK India has entered into a marketing arrangement with Kits Sports (KS UK), a UK incorporated firm. MK India uses the patented design provided by KS UK for manufacturing of cricket kits by it. MK India supplied 30,000 sports kits to KS UK for ₹ 5,000 per kit. In the assessment, the Assessing Officer, increased the price charged by MK India from KS UK to ₹ 6,000 per kit. MK India accepts such transfer price adjustment adopted by the Assessing officer. As a result, there is an increase in the income of MK India. You are required to answer the following questions in this respect:

(1) Would MK India and KS UK be treated as associate enterprises for the purposes of transfer pricing adjustment adopted by the Assessing Officer?

(2) What is the liability of KS UK in respect of the change in Arm's Length Price (ALP) in respect of purchases made by it from MK India?

(3) MK India contends that since the income is increased because of the arm's length price adopted by the Assessing Officer, the deduction claimed by it under section 10AA should also be increased accordingly, since the amount of deduction is based upon the amount of the export sale. Discuss whether the contention of MK India is valid.

Answer

(1) Manufacturing of cricket kits by MK India is wholly dependent on the use of patented design provided by KS UK and therefore MK India and KS UK are deemed to be associated enterprises as per section 92A(2).

Supply of cricket kits by MK India, a resident, to KS UK, a non-resident, would be an

international transaction between associated enterprises, and hence, transfer pricing provisions would be attracted in this case.

(2) The increased amount of ₹ 3 crore shall be treated as an advance given by M.K. India to KS UK which is required to be repatriated by KS UK within 90 days from the date of order.

(3) As per the first proviso to section 92C(4), in respect of the increased income of ₹ 3 crores, no deduction under section 10AA shall be allowed to MK India.

Hence, the contention of MK India that deduction under section 10AA should be increased is **not** valid.

Question 19

Research & Co. is engaged in providing scientific research services to several non- resident clients. Such services are also provided to B Inc., which guarantees 15% of the total loans of Research & Co.

(i) Examine whether transfer pricing provisions are attracted in respect of this transaction.

(ii) Without prejudice to the answer to (i) above, assuming that transfer pricing provisions are attracted in this case and that the Assessing Officer had made a primary adjustment of ₹ 225 lakhs to transfer price in the P.Y. 2017-18 vide order dated 1.4.2019 and the same was accepted by Research & Co., what are the consequent requirements as per the Income-tax Act, 1961 and the implications of non-compliance with the said requirements? Assume that the transaction is denominated in Indian Rupees and no amount has been repatriated upto 31.3.2020. The one year marginal cost of fund lending rate of State Bank of India as on 1.4.2019 is 8.15%.

Answer

(i) Provision of scientific research services falls within the scope of international transaction under section 92B. Research & Co. and B Inc. are deemed to be associated enterprises as per section 92A(2), since B Inc. guarantees not less than 10% of the total borrowings of Research & Co. Since there is an international transaction between associated enterprises, transfer pricing provisions are attracted in this case.

(ii) Where the Assessing Officer has made a primary adjustment of ₹ 225 lakhs to the transfer price and the same has been accepted by Research & Co., secondary adjustment has to be made in the books of account. The excess money determined based on the primary adjustment has to be repatriated to India within 90 days from the date of order, failing which the same would be deemed as an advance and interest would be attracted at the one year marginal cost of fund lending rate of State Bank of India as on 1.4.2019 + 3.25%, since the international transaction has been denominated in Indian Rupees. In this case, since the excess money has not been repatriated within 90 days, the same would be deemed to be an advance made by Research & Co. to B Inc. and interest would be attracted@11.40% (8.15% + 3.25%).

Question 20

Narmada Ltd., an Indian Company has borrowed ₹ 80 crores on 01-04-2019 from M/s. Thames Inc, a Company incorporated in London, at an interest rate of 10% p.a. The said loan is repayable over a period of 5 years. Further, loan is guaranteed by M/s Tyne Inc. incorporated in UK. M/s. Tweed Inc, a non-resident, holds shares carrying 40% of voting power both in M/s Narmada Ltd. and M/s Tyne Inc.

Net profit of M/s. Narmada Ltd. for P.Y. 2019-20 was ₹ 7 crores after debiting the above interest, depreciation of ₹ 4 crores and income-tax of ₹ 3 crores. Calculate the amount of interest to be disallowed under the head "Profits and gains of business or profession" in the computation of M/s Narmada Ltd., giving appropriate reasons.

Answer

If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds ₹ 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 94B.

Further, where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise and limitation of interest deduction would be applicable.

In the present case, since M/s Tweed Inc holds 40% of voting power i.e., more than 26% of voting power in both Narmada Ltd and M/s Tyne Inc, Narmada Ltd. and M/s Tyne Inc are deemed to be associated enterprises.

Since loan of ₹ 80 crores taken by Narmada Ltd., an Indian company from M/s Thames Inc, is guaranteed by M/s Tyne Inc, an associated enterprise of Narmada Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s Thames Inc shall be considered for the purpose of limitation of interest deduction under section 94B.

Computation of interest to be disallowed as per section 94B in the computation of income under the head profits and gains of business or profession of M/s. Narmada Ltd.

Particulars		₹
Net profit		7,00,00,000
Add: Interest already debited (₹ 80 crores x 10%)		8,00,00,000
Depreciation		4,00,00,000
Income tax		3,00,00,000
EBITDA		**22,00,00,000**
Interest paid or payable by Narmada Ltd.		8,00,00,000
Lower of the following would be disallowed		
- Total interest paid or payable in excess of 30% of EBITDA (₹ 8,00,00,000 – ₹6,60,00,000)	₹1,40,00,000	
- Interest paid or payable to non-resident AE	₹8,00,00,000	
Interest to be disallowed as deduction		**1,40,00,000**

Question 21

Beta Inc. having its business in Singapore has advanced a loan of SD 1,60,000 to Beta Ltd, Mumbai. Book value of total assets of Beta Ltd was ₹ 125 lakhs. Beta Ltd provides software backup support to Beta Inc. Beta Ltd has spent 50,000 manhour during the financial year 2019-20 for the services rendered to Beta Inc. The cost for Beta Ltd is SD 75 / manhour. Beta Ltd has billed Beta Inc. at SD 90.75 / manhour.

Gama Ltd. in Mumbai which has a similar business model, provides software backup support to Olive Inc. in Penang, Malaysia. Gama Ltd's cost and operating profits are as hereunder:

Particulars	INR in lakhs
Direct costs	600
Indirect costs	200
Operating profits	200

(1) Calculate Arm's Length Price for the transaction between Beta Ltd. and Beta Inc. based on the above data of Gama Ltd. using the Transactional Net Margin Method. Assume ISD = ₹ 45.

(2) Explain, if there is any adjustment to be made to the total income of Beta Ltd.

Note: SD = Singapore Dollars

Answer

Two enterprises are deemed to be associated enterprises where one enterprise advances loan constituting not less than 51% of the book value of the total assets of the other enterprise.

In this case, since Beta Inc., a foreign company, has advanced loan to Beta Ltd., an Indian company, and such loan constitutes 57.6% [(₹ 45 x 1,60,000 x 100/1,25,00,000] of the book value of total assets of Beta Ltd., Beta Inc and Beta Ltd. are deemed to be associated enterprises.

Since the transaction of provision of software backup support by Beta Ltd. to Beta Inc. is an international transaction between associated enterprises the provisions of transfer pricing would be attracted in this case.

Determination of Operating Margin of transaction of provision of software backup support. by Beta Ltd. to Beta Inc

Particulars	₹
Billing per manhour [SD 90.75/hour x ₹45]	4,083.75
Cost per man hour [SD 75/hour x ₹45]	3,375.00
Operating profit per manhour	**708.75**
Operating profits to cost (%) **[708.75 x 100/3375] = 21%**	

Determination of Operating Margin of Comparable Uncontrolled transaction i.e., provision of software backup support. by Gama Ltd. to Olive Inc

Particulars	₹ in lakhs
Direct Cost	600
Indirect Cost	200
Total cost	**800**
Operating profits	200
Operating profits to cost (%) **[200 x 100/800] = 25%**	

(1) Computation of Arm's Length Price of provision of software backup support provided by Beta Ltd. to Beta Inc. by applying TNMM

Particulars	₹
Cost for Beta Ltd. (per man hour) [SD 75 x ₹ 45/SD]	3,375.00
Add: Arm's length operating profit margin as % of cost (25% of ₹3,375)	843.75
Arm's length price (per manhour) in INR **[See Note]**	**4,218.75**
Arm's length price of total manhours spent by Beta Ltd. for providing software backup support to Beta Inc. [₹ 4,218.75 x 50,000 man hours] = ₹ 21,09,37,500	

(2) Adjustment to be made to the total income of Beta Ltd.

Particulars	₹
Arm's length price of total manhours spent by Beta Ltd. for providing software backup support to Beta Inc.	21,09,37,500
Less: Amount actually billed [90.75 SD x ₹ 45/SD x 50,000 manhours]	20,41,87,500
Arm's length adjustment to be made to the total income of Beta Ltd.	**67,50,000**

Question 22

DIY Ltd., a company registered in India and subsidiary of CD Inc., a company registered in Austria. DIY Ltd. engaged in the manufacturing of fabric. To arrive at the arm's length price applicable to its transactions with CD Inc., DIY Ltd. enters into an advance pricing agreement with the Board on 25th November 2019. Accordingly, there will be a substantial change in the income of DIY Ltd. Also, DIY Ltd. wishes to apply for roll back provisions to PY 2015-16, 2016-17, 2017-18 and 2018-19.

The AO wants to apply such transfer pricing provisions from the year in which DIY Ltd. became the subsidiary of CD Inc. i.e., A.Y. 2013-14 onwards.

DIY Ltd. had filed its return of income for the A.Y. 2019-20 on 26th August 2019 and for A.Y. 2020-21, on 31st August, 2020. The assessments for the A.Ys 2016-17 to 2019-20 are completed but the assessment of A.Y. 2020-21 is pending on the date of entering into APA.

You are required to answer the following questions:

(i) Whether the AO is correct to apply the transfer pricing provisions from A.Y. 2013-14 onwards?

(ii) In respect of A.Y. 2017-18, the transfer price arrived at by the Board is resulting in reduction in income of the assessee. Discuss whether the roll back provisions can be applied for that assessment year as well.

(iii) What will happen to completed as well as pending assessments?

Answer

(i) No; the Assessing Officer is not correct in applying transfer pricing provisions as per the advance pricing agreement from A.Y.2013-14 itself.

This is so since roll back provisions can be applied only for any previous year, falling within the period not exceeding four previous years, preceding the first of the five consecutive previous years as may be specified in the agreement. Since P.Y.2019-20 is the first of the five consecutive previous years, roll back provisions can be applied only from A.Y.2016-17 (relevant to P.Y.2015-16) and not from A.Y.2013-14.

(ii) No; the rollback provision cannot be applied in respect of an international transaction for a rollback year, if the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year already filed by the assessee prior to the filing of the APA.

Accordingly, the roll back provisions cannot be applied in respect of A.Y.2017-18, since it has the effect of reduction in income of DIY Ltd. for that year.

(iii) DIY Ltd. has to furnish modified return in respect of the assessment years relevant to the previous year to which APA applies (and for which returns have already been furnished before entering into an APA) within a period of 3 months from the end of the month in which the agreement was entered into i.e., on or before 28th February 2020. The modifications therein should arise only because of the APA. Such return would be treated as a return filed under section 139(1).

In case of completed assessments (i.e., assessments made upto A.Y.2019-20 other than A.Y.2017-18), the Assessing Officer would assess or reassess or recompute the total income of the relevant assessment year having regard to the APA. Such order of assessment has to be passed within a period of one year from the end of the financial year in which the modified return was furnished.

In respect of pending assessment (i.e., assessment for A.Y.2020-21), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the APA taking into consideration the return furnished by the assessee, since the same has been furnished after the date of entering into the APA.

Question 23

Examine with reasons whether the two enterprises referred to in the independent situations given below can be deemed to be associated enterprises under the Indian transfer pricing regulations:

(i) Kingston Inc, a US company having its place of effective management also in the USA, has advanced a loan equivalent to ₹ 130 crores to Ganga Ltd., an Indian company on 10-4-2019.

The total book value of assets of Ganga Ltd. is ₹ 250 crores. The market value of the assets, however, is ₹ 300 crores. Ganga Ltd. repaid ₹ 22 crores before 31-3-2020.

(ii) Charles plc., a UK company having its place of effective management also in the UK, has the power to appoint 4 of the directors of Andes Ltd, an Indian company, whose total number of directors in the Board is 9.

(iii) Total value of raw materials and consumables of Kaveri Ltd., an Indian company, is ₹ 720 crores. Of this, supplies to the tune of ₹ 650 crores are by Aurubis GmbH, a German company having its place of effective management in Germany, at prices and terms decided by the German company.

Answer

(i) Kingston Inc, a foreign company, has advanced loan of ₹ 130 crores to Ganga Ltd., an Indian company, which amounts to 52% of book value of assets of Ganga Ltd. Since the loan advanced by Kingston Inc. is 51% or more of the book value of assets of Ganga Ltd., Kingston Inc. and Ganga Ltd. are deemed to be associated enterprises under the Indian transfer pricing regulations.

The deeming provisions would be attracted even if there is a repayment of loan during the same previous year which brings down the said percentage below 51%.

(ii) Charles plc, a foreign company has the power to appoint 44.44% (4 out of 9) of the directors of an Indian company, Andes Ltd.

Two enterprises would be deemed to be associated enterprises **if more than half of the board of directors** of one enterprise **are appointed by the other enterprise.**

In this case, since Charles plc has the power to appoint only 44.44% (which is less than half) of the directors of an Indian company, Andes Ltd., Charles plc and Andes Ltd. are **not** deemed to be associated enterprises.

(iii) Since Aurubis GmbH, a German company, supplies 90.27% of the raw materials and consumables required by Kaveri Ltd., an Indian company, which is more than the specified threshold of 90%; and the prices and terms of supply are decided by the German company, the two companies are deemed to be associated enterprises.

CHAPTER - 2
Non Resident Taxation

Section A – ICAI Study Material Questions

Question 1

ABC Inc., a Swedish company headquartered at Stockholm, not having a permanent establishment in India, has set up a liaison office in Mumbai in April, 2019 in compliance with RBI guidelines to look after its day to day business operations in India, spread awareness about the company's products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Directors at Sweden. Determine the residential status of ABC Inc. for A.Y. 2020-21.

Answer

Section 6(3) provide that a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India .

In this case, ABC Inc. is a foreign company. Therefore, it would be resident in India for P.Y.2019-20 only if its place of effective management, in that year, is in India.

Explanation to section 6(3) defines "place of effective management" to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. In the case of ABC Inc., its place of effective management for P.Y.2019-20 is not in India, since the significant management and commercial decisions are, in substance, made by the Board of Directors outside India in Sweden.

ABC Inc. has only a liaison office in India through which it looks after its routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.

Hence, ABC Inc., being a foreign company is a non-resident for A.Y.2020-21, since its place of effective management is outside India in the P.Y.2019-20.

Question 2

J, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India for the year ended 31.3.2020 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2020-21. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2020-21.

Answer

As per section 9(1)(iii), salaries payable by the Government to a citizen of India for services rendered outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y. 2020-21.

As per section 10(7), all allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India is exempt from tax. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

Question 3

Mr. Soham, an Indian Citizen, left India on 20-04-2017 for the first time to setup a software firm in Singapore. On 10-04-2019, he entered into an agreement with LK Limited, an Indian Company, for the transfer of technical documents and designs to setup an automobile factory in Faridabad. He reached India along with his team to render the requisite services on 15-05-2019 and was able to complete his assignment on 20-08-2019. He left for Singapore on 21-08-2019. He charged ₹ 50 lakhs for his services from LK Limited.

Determine the residential status of Mr. Soham for the Assessment Year 2020-21 and examine whether the fees charged from LK Limited would be chargeable to tax as per the Income-tax Act, 1961.

Answer

Determination of residential status of Mr. Soham

As per section 6(1), an individual is said to be resident in India in any previous year if he satisfies the conditions:-

(i) He has been in India during the previous year for a total period of 182 days or more, or

(ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year or an Indian citizen, who being outside India, comes on a visit to India in any previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. Soham is an Indian citizen who left India to set up a software firm in Singapore on 20.04.2017. Therefore, he is an Indian citizen living in Singapore, who comes on a visit to India during the P.Y.2019-20. His stay in India during the period of his visit is only 99 days (i.e., 17+30+31+21 days). Since his stay in India during the previous year 2019-20 is only 99 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y.2020-21 is Non-Resident.

Taxability of income

As per section 5(2), in case of a non-resident, only income which accrues or arises or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year is taxable in India.

In this case, Mr. Soham, a non-resident, charges fees from LK Ltd., an Indian company, for transfer of technical documents and designs to set up an automobile factory in Faridabad. He renders the requisite services in India for which he stays in India for 99 days during the P.Y.2019-20.

Section 9(1)(vi) defines "royalty" to mean consideration for transfer of all or any rights in respect of, inter alia, a design and also for the rendering of services in connection with such activity. Transfer of rights in the above definition includes transfer of right for use or right to use a computer software also. Therefore, the fees received by Mr. Soham for transfer of technical documents and designs and rendering of requisite services in relation thereto would fall within the meaning of "royalty".

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident (in this case, LK Limited, an Indian company) would be deemed to accrue or arise in India in the hands of the non-resident (Mr. Soham, in this case), except where such royalty is payable in respect of any right or property or information used or for services utilized for the purpose of a business carried on by such person outside India or for the purposes of making or earning income from any source outside India.

In this case, since the royalty is payable by LK Limited, an Indian company, to Mr. Soham, a non-resident, in respect of services utilized for a business in India (namely, for setting up an automobile factory in Faridabad), the same is deemed to accrue or arise in India and is hence, taxable in India in the hands of Mr. Soham, a non-resident for the A.Y. 2020-21.

Question 4

Miss Vivitha paid a sum of 5000 USD to Mr. Kulasekhara, a management consultant practising in Colombo, specializing in project financing. The payment was made in Colombo. Mr. Kulasekhara is a non-resident. The consultancy is related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara?

Answer

A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India.

The income deemed to accrue or arise in India under section 9 comprises, inter alia, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of "fees for technical services".

The Explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India or whether or not the non-resident has a residence or place of business or business connection in India.

In the instant case, since the services were utilized in India, the payment received by Mr. Kulasekhara, a non-resident, in Colombo is chargeable to tax in his hands in India, as it is deemed to accrue or arise in India.

Question 5

Compute the total income in the hands of an individual, aged 55 years, being a resident and ordinarily resident, resident but not ordinarily resident, and non-resident for the A.Y. 2020-21:

Particulars	Amount (₹)
Interest on UK Development Bonds, 50% of interest received in India	10,000
Income from a business in Chennai (50% is received in India)	20,000
Short term capital gains on sale of shares of an Indian company received in London	20,000
Dividend from British company received in London	5,000
Long term capital gains on sale of plant at Germany, 50% of profits are received in India	40,000
Income earned from business in Germany which is controlled from Delhi (₹ 40,000 is received in India)	70,000
Profits from a business in Delhi but managed entirely from London	15,000
Income from house property in London deposited in an Indian Bank at London, brought to India (Computed)	50,000
Interest on debentures in an Indian company received in London	12,000

Fees for technical services rendered in India but received in London	8,000
Profits from a business in Bombay managed from London	26,000
Pension for services rendered in India but received in Burma	4,000
Income from property situated in Pakistan, received there	16,000
Past foreign untaxed income brought to India during the previous year	5,000
Income from agricultural land in Nepal received there and then brought to India	18,000
Income from profession in Kenya which was set up in India, received there but spent in India	5,000
Gift received on the occasion of his wedding	20,000
Interest on savings bank deposit in State Bank of India	12,000
Income from a business in Russia, controlled from Russia	20,000
Dividend from Reliance Petroleum Limited, an Indian Company	5,000
Agricultural income from a land in Rajasthan	15,000

Answer

Computation of total income for the A.Y. 2020-21

Particulars	Resident and ordinarily resident ₹	Resident but not ordinarily resident ₹	Non-resident ₹
Interest on UK Development Bonds, 50% of interest received in India	10,000	5,000	5,000
Income from a business in Chennai (50% is received in India)	20,000	20,000	20,000
Short term capital gains on sale of shares of an Indian company received in London	20,000	20,000	20,000
Dividend from British company received in London	5,000	-	-
Long term capital gain on sale of plant at Germany, 50% of profits are received in India	40,000	20,000	20,000
Income earned from business in Germany which is controlled from Delhi, out of which ₹ 40,000 is received in India	70,000	70,000	40,000
Profits from a business in Delhi but managed entirely from London	15,000	15,000	15,000
Income from property in London deposited in a Bank at London, later on remitted to India	50,000	-	-
Interest on debentures in an Indian company received in London	12,000	12,000	12,000
Fees for technical services rendered in India but received in London	8,000	8,000	8,000
Profits from a business in Bombay managed from London	26,000	26,000	26,000
Pension for services rendered in India but received in Burma	4,000	4,000	4,000

Income from property situated in Pakistan, received there	16,000	-	-
Past foreign untaxed income brought to India during the previous year	-	-	-
Income from agricultural land in Nepal received there and then brought to India	18,000	-	-
Income from profession in Kenya which was set up in India, received there but spent in India	5,000	5,000	-
Gift received on the occasion of his wedding [not taxable]	-	-	-
Interest on savings bank deposit in State Bank of India	12,000	12,000	12,000
Income from a business in Russia, controlled from Russia	20,000	-	-
Dividend from Reliance Petroleum Limited, an Indian Company [Exempt under section 10(34)]	-	-	-
Agricultural income from a land in Rajasthan [Exempt under section 10(1)]	-	-	-
Gross Total Income	3,51,000	2,17,000	1,82,000
Less: Deduction under section 80TTA			
[Interest on savings bank account subject to a maximum of ₹10,000]	10,000	10,000	10,000
Total Income	3,41,000	2,07,000	1,72,000

Question 6

Sea Port Shipping Line, a non-resident foreign company ships is engaged in the business of carriage of goods shipped at Mumbai port. During the previous year ended on 31.3.2020, it had collected freight of 100 lakhs, demurrages of ₹ 20 lakhs and handling charges of ₹ 10 lakhs. The expenses of operating its fleet during the year for the Indian Ports were ₹ 110 lakhs. Compute its income applying the presumptive provisions under section 44B.

Answer

Section 44B provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The above amounts will include demurrage charges and handling charges.

These provisions for computation of income from the shipping business in case of non-residents

would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961.

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax on deemed profit of ₹ 9.75 lacs (7.50% on the total receipts of ₹ 130 lacs). The tax payable would be reduced by the amount of tax paid under section 172(4).

Question 7

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2020:

(i) ₹ 2 crores in India on account of carriage of passengers from Chennai.

(ii) ₹ 1 crore in India on account of carriage of goods from Chennai.

(iii) ₹ 3 crores in India on account of carriage of passengers from Singapore.

(iv) ₹ 1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2020 was ₹ 6.75 crores.

Compute the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2020-21.

What would be your answer in case the business was carried on by a foreign company, Q Airlines (P) Ltd?

Answer

Section 44BBA says for computing profits and gains of the business of operation of aircraft in the case of non-residents a sum equal to 5% of the aggregate of the following amounts -

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Keeping in view the provisions of section 44BBA, the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder-

Particulars	₹
Amount received in India on account of carriage of passengers from Chennai	2,00,00,000
Amount received in India on account of carriage of goods from Chennai	1,00,00,000
Amount received in India on account of carriage of passengers from Singapore	3,00,00,000
Amount received in Singapore on account of carriage of passengers from Chennai	1,00,00,000
	7,00,00,000

Income from business under section 44BBA at 5% of ₹ 7,00,00,000 is ₹ 35,00,000, which is the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2020-21.

In case the assessee is a foreign company, say, Q Airlines (P) Ltd, the answer would be the same since section 44BBA does not distinguish corporate and non-corporate taxpayers who operate aircraft provided their residential status is that of non-resident.

Question 8

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2020 was a loss of ₹ 100 lakhs after charge of head office expenses of ₹ 200 lakhs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2020-21.

Answer

Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of ₹ 200 Lakhs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2020-21 will be as under:

Particulars	₹
Net loss for the year ended on 31.03.2020	(100 lakhs)
Add: Amount of head office expenses to be considered separately as per section 44C	200 lakhs
Adjusted total income	100 lakhs
Less: Head Office expenses allowable under section 44C is the lower of - (i) ₹ 5 lakhs, being 5% of ₹ 100 lakhs, or (ii) ₹ 200 lakhs.	5 lakhs
Income to be declared in return	**95 lakhs**

Question 9

Mr. A, a non-resident Indian remits US $ 40,000 to India on 16.09.2005. The amount is partly utilised on 3.10.2005 for purchasing 10,000 equity shares in A Ltd, an Indian Company, at the rate of ₹ 12 per share. These shares are sold for ₹ 48 per share on 30.03.2020. Fair Market value of these shares on 31.01.2018 was ₹ 35 per share.

The telegraphic transfer buying and selling rate of US dollars adopted by the State Bank of India is as follows :-

Date	Buying Rate (1 US$)	Selling Rate (1 US $)
16.09.2005	18	20
3.10.2005	19	21
30.3.2020	59	61

Compute Capital gain chargeable to tax for the A.Y. 2020-21 on the assumption that –

(a) These shares have not been sold through a recognised stock exchange

(b) These shares have been purchased and sold through a recognised stock exchange.

Answer

(a) Where the shares are not sold through recognised stock exchange

Particulars	US $
Sale consideration (₹ 4,80,000/60)	8000
Less: Cost of Acquisition (1,20,000/20)	6000
Long term capital gain	**2000**

Long-term capital gain converted into $ 2000 x ₹ 59 = ₹ 1,18,000

(b) Where the shares are purchased and sold through a recognised stock exchange

Particulars		₹
Sale consideration		4,80,000
Less: Cost of Acquisition		
Higher of the following		
Cost of acquisition	1,20,000	
Lower of Fair market value as on 31.1.2018 and Full value of consideration (i.e., lower of ₹ 3,50,000 and ₹ 4,80,000)	3,50,000	3,50,000
Long term capital gain		**1,30,000**

Long term capital gains upto ₹ 1,00,000 would be exempt. Long term capital gains exceeding ₹ 1,00,000, i.e., ₹ 30,000 is taxable @10% under section 112A.

Question 10

A non-resident Indian acquired shares in an Indian company, A Ltd., on 1.1.2009 for ₹ 1,00,000 in foreign currency. These shares are sold by him on 1.1.2019 for ₹ 3,00,000. He invests ₹ 3,00,000 in shares on 31.03.2019 and these shares are sold by him on 30.06.2019 for ₹ 3,50,000. Discuss the tax implications. Ignore the effect of first proviso to section 48.

Answer

Computation of Long term Capital Gain for Assessment Year 2019-20

Particulars	Amount (₹)
Sale consideration	3,00,000
Less: Cost of Acquisition	1,00,000
Long term capital gain	2,00,000
Less: Exemption under section 115F	2,00,000
Exempt long-term capital gain	**NIL**

Capital Gain for Assessment year 2020-21:

1. LTCG of ₹ 2,00,000 which was exempt in A.Y.2019-20 becomes taxable this year.
2. STCG of ₹ 50,000 is also taxable this year.

Question 11

Mr. John, a non-resident Indian, purchased unlisted shares of an Indian Company at a cost of ₹ 70,000 on 01.07.20010 in foreign currency. Mr. John sold the said shares for a consideration of ₹ 2,50,000 on 01.08.2019 and the expenditure incurred wholly or exclusively in connection with the transfer is ₹ 10,000. Compute the taxable capital gain if he deposited in specified assets ₹ 1,50,000 out of sale consideration. Ignore the effect of first proviso to section 48.

Answer

Particulars	Amount (₹)
Sale Consideration	2,50,000
Less: Transfer Expenses	10,000

Net Consideration	2,40,000
Less: Cost of Acquisition	70,000
Long-term capital gain	1,70,000
Less: Exemption u/s 115F (1,70,000*1,50,000/2,40,000)	1,06,250
Taxable long-term capital gain	**63,750**

Question 12

During the financial year 2019-20, Nadal, a tennis professional and a non-Indian citizen participated in India in a Tennis Tournament and won prize money of ₹ 15 lakhs. He contributed articles on the tournament in a local newspaper for which he was paid ₹ 1 lakh. He was also paid ₹ 5 lakhs by a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur ₹ 3 lakhs towards his travel costs to India. He was a non-resident for tax purposes in India.

What would be his tax liability in India for A.Y. 2020-21? Is he required to file his return of income?

Answer

Under section 115BBA, all the three items of receipts in India viz. prize money of ₹ 15 lakhs, amount received from newspaper of ₹ 1 lakh and amount received towards TV advertisement of ₹ 5 lakhs - are chargeable to tax. No expenditure is allowable as deduction against such receipts. The rate of tax chargeable under section 115BBA is 20%, plus health and education cess @4%. The total tax liability works out to ₹ 4,36,800 being 20.8% of ₹ 21 lakhs. Thus, Nadal will be liable to tax on the income earned in India

He is not required to file his return of income if -

(a) his total income during the previous year consists only of income arising under section 115BBA; **and**

(b) the tax deductible at source under the provisions of Chapter XVII-B have been deducted from such incomes.

Question 13

Smith, a foreign national and a cricketer came to India as a member of Australian cricket team in the year ended 31st March, 2020. He received ₹ 5 lakhs for participation in matches in India. He also received ₹ 1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received ₹ 10,000. When he stayed in India, he also won a prize of ₹ 20,000 from horse racing in Mumbai. He has no other income in India during the year.

(i) Compute tax liability of Smith for Assessment Year 2020-21.

(ii) Are the income specified above subject to deduction of tax at source?

(iii) Is he liable to file his return of income for Assessment Year 2020-21?

(iv) What would have been his tax liability, had he been a match referee instead of a cricketer?

Answer

(i) Computation of tax liability of Smith for the A.Y.2020-21

Particulars	₹	₹
Income taxable under section 115BBA		
Income from participation in matches in India	5,00,000	
Advertisement of product on TV	1,00,000	
Contribution of articles in newspaper	10,000	
Income taxable under section 115BB		
Income from horse races	20,000	
Total income	**6,30,000**	
Tax@ 20% under section 115BBA on ₹ 6,10,000		1,22,000
Tax@ 30% under section 115BB on income of ₹ 20,000 from horse races		6,000
		1,28,000
Add: Health and Education cess@4%		5,120
Total tax liability of Smith for the A.Y.2020-21		**1,33,120**

(ii) Yes, the above income is subject to tax deduction at source.

Income referred to in section 115BBA (i.e., ₹ 6,10,000, in this case) is subject to tax deduction at source@ 20% under section 194E.

Income referred to in section 115BB (i.e., ₹ 20,000, in this case) is subject to tax deduction at source@30% under section 194BB.

Since Smith is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by health and education cess@4%.

(iii) Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. However, in this case, Mr. Smith has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for A.Y.2020-21.

(iv) The Calcutta High Court in Indcom v. CIT (TDS)(2011) 335 ITR 485 has held that 'match referee' would not fall within the meaning of "sportsmen" to attract the provisions of section 115BBA. Therefore, although the payments made to non-resident 'match referee' are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA. They are subject to the normal rates of tax.

Particulars		₹
Tax@30% under section 115BB on winnings of ₹ 20,000 from horse races		6,000
Tax on ₹ 6,10,000 at the rates in force		
Upto ₹ 2,50,000	Nil	
2,50,000 – 5,00,000 @5%	12,500	
5,00,000 – 6,10,000 @ 20%	22,000	34,500
		40,500
Add: Health and Education cess@4%		1,620
Total tax liability		**42,120**

Question 14

Peeyush, returned to India on 12th June, 2019 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various incomes and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2020-21:

(i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2019.

(ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of ₹ 75,000 in U.K. in foreign currency (not received in India) and of ₹ 20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at ₹ 37,500 while in terms of Indian Rupee it was ₹ 50,000.

Answer

Peeyush returned to India on 12th June 2019 for permanently residing in India after staying in UK for 20 years. During the P.Y.2019-20, he stays in India for 294 days. Since he has stayed in India for a period of 182 days or more during the previous year 2019-20, he would be a resident in India for the A.Y.2020-21. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2019-20 and his stay in India during the seven previous years is less than 730 days. The residential status of Peeyush for A.Y.2020-21 is, therefore, **Resident but Not Ordinarily Resident.**

As per section 5(1), only income which is received/ deemed to be received/ accrued or arisen/ deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of ₹ 1,500 per child under section 10(32). Accordingly, income of ₹ 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of ₹ 1,500. Therefore, ₹18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Peeyush.

Since the other son is major, his income is not includible in the income of Peeyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Peeyush was a non-resident, is not taxable in the A.Y.2020-21 since it is not the income of the P.Y.2019-20.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2020-21. Since his total income (i.e., ₹ 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2020-21.

Question 15

Mr. David, a citizen of India, serving in the Ministry of External Affairs in India, was transferred to Indian Embassy in Canada on 31.03.2019. He did not visit India any time during the previous year 2019-20. He has received the following income for the Financial Year 2019-20:

S.No.	Particulars	₹
(i)	Salary (Computed)	5,00,000
(ii)	Foreign Allowance	4,00,000
(iii)	Interest on fixed deposit from bank in India	1,00,000
(iv)	Income from agriculture in Pakistan	2,00,000
(v)	Income from house property in Pakistan	2,50,000

Compute his gross total income for Assessment Year 2020-21.

Answer

As per section 6(1), Mr. David is a non-resident for the A.Y. 2020-21, since he was not present in India at any time during the previous year 2019-20.

As per section 5(2), a non-resident is chargeable to tax in India only in respect of following incomes:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

(iii) In view of the above provisions, income from agriculture in Pakistan and income from house property in Pakistan would not be chargeable to tax in the hands of David, assuming that the same were received in Pakistan.

(iv) Income from 'Salaries' payable by the Government to a citizen of India for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii). Hence, such income is taxable in the hands of Mr. David, even though he is a non-resident.

(v) However, allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India is exempt under section 10(7). Hence, foreign allowance of ₹ 4,00,000 is exempt under section 10(7).

Gross Total Income of Mr. David for A.Y. 2020-21

Particulars	₹
Salaries	5,00,000
Income from other sources (Interest on fixed deposit in India)	1,00,000
Gross Total Income	**6,00,000**

Question 16

Mr. A, a citizen of India, left for USA for the purposes of employment on 1.5.2019. He has not visited India thereafter. Mr. A borrows money from his friend Mr. B, who also left India for employment purpose one week before Mr. A's departure, to the extent of ₹ 10 lakhs and buys

shares in X Ltd., an Indian company. Discuss the taxability of the interest charged @10% in B's hands where the same has been received in New York.

Answer

An individual is said to be resident in India in any previous year, if he -

(i) has been in India during that year for a total period of 182 days or more, or

(ii) has been in India during the four years immediately preceding that year for a total period of 365 days or more and has been in India for at least 60 days in that year.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. A is an Indian citizen who left India for employment outside India on 01.05.2019. Mr. A has been in India only from 1.4.2019 to 01.05.2019 i.e. for 31 days. Since his stay in India during the previous year 2019-20 is only 31 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y. 2020-21 is Non-Resident. Mr. B, who left India one week before A's departure, is also a non-resident for the same reasons.

Section 9(1)(v) provides that income by way of interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India shall be deemed to accrue or arise in India.

Therefore, interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purpose of making or earning any income from any source other than a business or profession carried on by him in India, shall not be deemed to accrue or arise in India. Therefore, interest payable by Mr. A on money borrowed from Mr. B to invest in shares of an Indian company shall not be deemed to accrue or arise in India and hence, is not taxable in India in the hands of Mr. B.

Question 17

JJ Limited, a company incorporated in Australia has entered into an agreement with KK Limited, an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, JJ Limited rendered both off-shore services and on-shore services to KK Limited at fee of ₹ 1 crore and ₹ 1.5 crore, respectively. JJ Limited is of the view that it is not liable to tax in India in respect of fee of ₹ 1 crore as it is for rendering services outside India. Discuss the correctness of the view of JJ Limited.

Answer

The Explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per the Explanation below section 9(2), the fee of ₹ 2.5 crore for technical services rendered by JJ Ltd. (both off-shore and on-shore services) to KK Ltd. is deemed to accrue or arise in India and includible in the total income of JJ Ltd.

Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of ₹ 1 crore (as it is for rendering services outside India) is not correct.

Question 18

Examine with reasons whether the following transactions attract income-tax in India, in the hands of recipients under section 9 of Income-tax Act, 1961:

(i) A non-resident German company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made towards drawings & designs, which were described as "Engineering Fee". The assessee contended that such business profits should be taxable in Germany as there is no business connection within the meaning of section 9(1)(i) of the Income-tax Act, 1961.

(ii) A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement.

(iii) Amount paid by Government of India for use of a patent developed by Mr. A, who is a non-resident.

(iv) Sai Engineering, a non-resident foreign company entered into a collaboration agreement on 25/6/2019, with an Indian Company and was in receipt of interest on 8% debentures for ₹ 20 lakhs, issued by Indian Company, in consideration of providing technical know-how utilised in its business in Mumbai during previous year 2019-20.

Answer

(i) Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as "engineering fee") are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii), since the services are utilized for execution of electrical work in India [Aeg Aktiengesllschaft v. CIT (2004) 267 ITR 209 (Kar.)].

As per Explanation to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non- resident German company, regardless of whether it has a residence or place of business or business connection in India.

(ii) As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India.

In this case, there was a professional connection between the firm of solicitors in Mumbai and the barrister in UK. The expression "business" includes not only trade and manufacture; it includes, within its scope, "profession" as well. Therefore, the existence of professional connection amounts to existence of "business connection" under section 9(1)(i). It was so held by the Supreme Court in Barendra Prasad Roy v. ITO (1981) 129 ITR 295.

Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

(iii) As per section 9(1)(vi), income by way of royalty payable by the Government of India is deemed to accrue or arise in India. "Royalty" means consideration for, inter alia, use of patent. Therefore, the amount paid by Government of India for use of patent developed by Mr. A, a non-resident, is deemed to accrue or arise in India. Hence, it is taxable in India in the hands of Mr. A.

(iv) ₹ 20 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how for use in its business in India, is in the nature of fee for technical services, deemed to accrue or arise in India to Sai Engineering, a non-resident foreign

company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Sai Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

Note – Since the question specifically requires the candidates to examine the taxability of the above transactions under section 9, the provisions of double taxation avoidance agreement, if any, applicable in the above cases, have not been taken into consideration.

Question 19

Z, an American tourist, comes to India for the first time on June 17, 2019. He leaves India on September 29, 2019. Determine his residential status for the assessment year 2020-21. Does it make any difference if he comes to India on a business trip or if he is an Indian citizen?

Answer

Previous year 2019-20: 105 [14+31+31+29]

Previous year 2018-19: Nil

Previous year 2017-18: Nil and so on ……

He is non-resident for the assessment year 2020-21 as he does not satisfy any of the basic conditions. It does not make any difference if he comes on a business trip to India.

Further, in this case, it does not make any difference if he is an Indian citizen as far as the answer of non-resident is concerned. However, there is a difference in application of basic conditions as an Indian citizen who comes on a visit to India during the previous has the option of only one basic condition of 182 days to become a resident.

Question 20

M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2019-20 (April, 2019 to March, 2020) and collected charges of ₹ 125 lakhs for carriage of passengers and cargo out of which ₹ 65 lakhs were received in New York in U.S Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were ₹ 195 lakhs. Compute the income chargeable to tax of the foreign airlines.

Answer

As per section 44BBA, in case of a non-resident engaged in the business of operation of aircraft, 5% of the following amounts would be deemed to be the profits and gains from such business:

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

In the present case, the income chargeable to tax of M/s Global Airlines applying the provisions of section 44BBA are as follows:

Particulars	Fare booked from India to outside India whether received in India or not (₹)	Fare booked from New York to Mumbai (₹)

Fare	60,00,000 (1,25,00,000 – 65,00,000)	65,00,000
Deemed income @5% u/s 44BBA	3,00,000 (60,00,000 × 5%)	Nil (since the amount not received in India)

Question 21

Atlant Italy, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers, and also made available to its customers, who used it to carry out their business activities. The Assessing Officer contented that the consideration for supply of software embedded in hardware is 'royalty' under section 9(1)(vi)

Examine the correctness of the action of the Assessing Officer assuming that the software that was loaded on the hardware and embedded in the system does not have any independent existence.

Answer

The issue under consideration in this case is whether consideration for supply of software embedded in hardware would tantamount to 'royalty' for attracting deemed accrual of income under section 9(1)(vi).

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident in India would be deemed to accrue or arise in India. However, where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, the amount payable by way royalty would not be deemed to accrue or arise in India, in the hands of non-resident.

For this purpose, 'royalty' includes transfer of all or any right for use or right to use a computer software irrespective of the medium through which such right is transferred.

The facts of the case are similar to the facts in CIT v. Alcatel Lucent Canada (2015) 372 ITR 476, wherein the above issue came up before the Delhi High Court. The Court observed that the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers. Where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as 'royalty' for software in terms of section 9(1)(vi).

In this case, since the software that was loaded on the hardware and embedded in the system does not have any independent existence, there could not be any independent use of such software. Therefore, the rationale of the Delhi High Court ruling can be applied to the case on hand. Accordingly, the action of the Assessing Officer in treating the consideration for supply of software embedded in hardware as royalty under section 9(1)(vi) is **not correct.**

Section B – Additional Questions

Question 22

Arnold Ltd. (incorporated in UK) has a branch office (PE) in India. The Net Profit of the Branch as per the statement of profit and loss for the year ended 31.03.2020 was ₹ 83 lakhs. It includes the following:

(i) Dividend from Indian companies (listed) ₹ 8,00,000.

(ii) Dividend from Indian companies (unlisted) ₹ 4,00,000.

(iii) Interest received from MMS Ltd. of Mumbai ₹ 7,00,000. The amount was received by the Indian company MMS Ltd. in foreign currency as per loan agreement dated 01.04.2015 (section 194LC applicable).

(iv) Fee for technical services received from Barun Co. Ltd., Kolkata ₹ 25,00,000. The agreement was made on 10.08.2008 and was approved by Central Government. Expenditure incurred for providing technical service amounts to ₹ 6,00,000.

Additional information:

Total income chargeable to tax as per regular provisions of the Income-tax Act, 1961 (Act) is ₹ 20,00,000 (without considering the items (i) to (iv) above).

You are required to compute the book profit tax under section 115JB of the Act for the assessment year 2020-21 and also the total income-tax liability of the assessee.

Your working should be supported by notes.

Answer

Computation of "Book Profit" for levy of MAT under section 115JB for A.Y.2020-21

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss		83,00,000
Less: **Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB:**		
- **Dividend income from listed and unlisted Indian companies, credited to statement of profit and loss** [Dividend income from listed and unlisted Indian companies is exempt u/s 10(34) read with section 115BBDA to the extent of ₹ 10 lakhs, in the hands of a foreign company. To this extent it can be reduced from net profit to arrive at book profit]	10,00,000	
- **Interest income received from an Indian company as per loan agreement dated 1.4.2015, where the loan is given in foreign currency** [Since income by way of interest chargeable @5% u/s 115A, being a rate lower than 15%, credited to statement of profit and loss, same has to be reduced to arrive at book profit]	7,00,000	
- **Fees for technical services under an agreement approved by the Central Government** [No adjustment is required since the foreign company carries on business through a permanent establishment i.e., a branch in India. Such income, being effectively connected with the branch in India, is taxable@40% under section 44DA. Since the income is not taxable at a rate less than 15% it should not be reduced for determining book profit]	Nil	17,00,000
Book Profit		**66,00,000**

Computation of tax liability

Particulars	₹	₹
Minimum Alternate Tax on book profit under section 115JB = 15% of ₹66,00,000		**9,90,000**
Income-tax computed as per the regular provisions of the Act		
- 40% [since Arnold Ltd. is a foreign company] of total income of ₹ 20 lakhs **plus** fees for technical services ₹ 19 lakhs (₹25 lakhs – ₹6 lakhs)]	15,60,000	
- Tax @10% of dividend income of ₹ 2 lakhs, being the dividend exceeding ₹10 lakhs	20,000	
- Tax@ 5% on interest of ₹7 lakhs received from MMS Ltd. as per loan agreement, the loan being given in foreign currency	35,000	
	16,15,000	
Since the income-tax computed as per the regular provisions of the Income-tax Act, 1961, is higher than the MAT liability, the income-tax payable would be computed as per the regular provisions of the Income-tax Act,1961:		
Income-tax computed as per regular provisions of Income- tax Act	16,15,000	
Add: Education cess @4%	64,600	
Total income-tax liability	**16,79,600**	

Assuming that the company is resident in India due to its POEM, being in India, in that year. Otherwise, the entire dividend of ₹12 lakhs has to be reduced to compute book profit.

Question 23

State with reasons whether the following transactions are subject to tax as deemed income.

(i) XYZ Ltd. is a broadcaster of News Channel in India. It had made payments to a Malaysian company having no PE in India for downlinking Television Channels into India and international footprint through a channel.

(ii) Mr. A, a foreign citizen and a diamond merchant from US, has earned income of ₹ 10 crores from display of uncut and unassorted diamonds in the Bharat Diamond Bourse, a notified special zone in Surat.

Answer

(i) As per section 9(1)(vi)(b), any income by way of royalty payable by a person who is a resident would be deemed to accrue or arise in India in the hands of the recipient, except where the royalty is payable in respect of any right, property or information or services utilised for the purposes of business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India.

Section 9(1)(vi) defines "royalty" to mean consideration for the transfer of any right in respect of, inter alia, a process. Explanation 6 to section 9(1)(vi) clarifies that "process" includes transmission by satellite (including conversion for down-linking of any signal).

Accordingly, the payment made by XYZ Ltd., a resident in India (since it is an Indian company), for downlinking television channels into India and international footprint through the channel, would constitute "royalty".

Such royalty income would be deemed to accrue or arise in India in the hands of the Malaysian company not having a PE in India, since it is paid by XYZ Ltd., a company resident in India in relation to its business in India.

(ii) As per section 9(1)(i)(e), in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut and unassorted diamonds in any notified special zone.

Since this benefit is available only in case of a foreign company engaged in the business of mining of diamonds, Mr. A, a foreign citizen and a diamond merchant from US, cannot avail of such benefit.

The income of ₹ 10 crores from display of uncut and unassorted diamonds would, accordingly, be deemed to accrue or arise in the hands of Mr. A by virtue of business connection in India.

Question 24

Examine the tax consequence for Assessment Year 2020-21 in respect of fees for technical services (FTS) received by Mr. Tom Sawyer, a non-resident, from Ganga Ltd., an Indian company, in pursuance of an agreement approved by the Central Government, if -

(a) India has no Double Tax Avoidance Agreement (DTAA) with Country A
(b) India has a DTAA with Country A, which provides for taxation of such FTS @5%.
(c) India has a DTAA with Country A, which provides for taxation of such FTS @15%.

The technical services are utilised by Ganga Ltd. for its business in Calcutta. Assume that Tom Sawyer is a resident of Country A and he has no fixed place of his profession in India.

Would your answer change if he has a fixed place of his profession in India and he renders technical services through that place? Examine, in a case where India has no DTAA with Country A.

Answer

As per section 9(1)(vii)(b), income by way of fees for technical services payable by a resident is deemed to accrue or arise in India, except where the fees is payable, inter alia, in respect of services utilized in a business or profession carried on by such person outside India. In this case, since Ganga Ltd. utilizes the technical services for its business in Calcutta, the fees for technical services payable by Ganga Ltd. is deemed to accrue or arise in India in the hands of Mr. Tom Sawyer.

In accordance with the provisions of section 115A, where the total income of a non- corporate non-resident includes any income by way of royalty or fees for technical services other than the income referred to in section 44DA(1), received from an Indian concern in pursuance of an agreement made by him with the Indian concern and the agreement is approved by the Central Government, then, the special rate of tax at 10% of such fees for technical services is applicable. No deduction would be allowable under sections 28 to 44C and section 57 while computing such income.

Section 90(2) makes it clear that where the Central Government has entered into a DTAA with a country outside India, then, in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. Therefore, if the DTAA provides for a rate lower than 10%, then, the provisions of DTAA would apply.

(a) In this case, since India does not have a DTAA with Country A, of which Tom Sawyer is a resident, the fees for technical services (FTS) received from Ganga Ltd., an Indian company, would be taxable @10%, by virtue of section 115A.

(b) In this case, the FTS from Ganga Ltd. would be taxable @5%, being the rate specified in the DTAA, even though section 115A provides for a higher rate of tax, since the tax rates specified in the DTAA are more beneficial. However, since Tom Sawyer is a non-resident, he has to furnish a tax residency certificate from the Government of Country A for claiming such benefit. Also, he has to furnish other information, namely, his nationality, his tax identification number in Country A and his address in Country A.

(c) In this case, the FTS from Ganga Ltd. would be taxable @10% as per section 115A, even though DTAA provides for a higher rate of tax, since the provisions of the Act (i.e. section 115A in this case) are more beneficial.

If Mr. Tom Sawyer has a fixed place of profession in India, and he renders technical services through the fixed place of profession, then, by virtue of section 44DA, such income by way of fees for technical services received by Mr. Tom Sawyer from Ganga Ltd., India, would be computed under "Profits and gains of business or profession" as per provisions of Income-tax Act, 1961, since technical services are provided from a fixed place of profession situated in India and fees for technical services is received from an Indian concern in pursuance of an agreement with the non-resident and is effectively connected with such fixed place of profession. No deduction would be allowed in respect of any expenditure which is not wholly and exclusively incurred for the fixed place of profession in India.

Mr. Tom Sawyer is required to keep and maintain books of account and other documents in accordance with the provisions contained in section 44AA and get his accounts audited by an accountant and furnish the report of such audit in the prescribed form duly signed and verified by such accountant along with the return of income.

It may be noted that the concessional rate of tax@10% under section 115A would not apply in this case.

Question 25

Examine with reasons whether the following transactions attract income-tax in India, in the hands of recipients under section 9 of Income-tax Act, 1961:

(i) A non-resident Australian company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made towards drawings & designs, which were described as "Engineering Fee". The assessee contended that such business profits should be taxable in Australia as there is no business connection as per section 9(1)(i) of Income-tax Act, 1961.

(ii) A firm of solicitors in Delhi engaged a barrister in Canada for arguing a case before Supreme Court of India. A payment of 5000 Canadian Dollars was made as per terms of professional engagement.

(iii) Dream Engineering, a non-resident foreign company entered into a collaboration agreement on 25/6/2019, with an Indian Company and was in receipt of interest on 8% debentures for Rs. 20 lakhs, issued by Indian Company, in consideration of providing technical know-how during previous year 2019-20.

Answer

(i) Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as “engineering fee”) are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii)

As per Explanation to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident Australian company, regardless of whether it has a residence or place of business or business connection in India or not.

(ii) As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India.

In this case, there was a professional connection between the firm of solicitors in Delhi and the barrister in Canada. “Business” includes not only trade and manufacture; it includes, within its scope, “profession” as well. Therefore, the existence of professional connection amounts to existence of “business connection” under section 9(1)(i).

Hence, the amount of 5,000 Canadian Dollars paid to the barrister in Canada as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

Note – Since he has represented a case in India, income can also be said to accrue or arise in India.

(iii) Rs. 20 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how, is in the nature of fee for technical services, deemed to accrue or arise in India to Dream Engineering, a non-resident foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Dream Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

Question 26

SOL Inc, a notified Foreign Institutional Investor (FII), derived the following incomes from various sources for the financial year 2019-20:-

(1) **Income in respect of securities:** ₹ 28,50,000
Expenses incurred in respect there of: ₹ 50,000

(The above income includes an interest of ₹16,00,000 received from an Indian Company on the investment in rupee denominated bonds and dividend income of ₹3,50,000 from a domestic company referred to in section 115-O)

(2) **Capital Gains:**

(i)	**Long Term :**	
	Sale proceeds on sale of securities on 15.01.2020 :	₹52,00,000
	Purchase cost of securities on 25.05.2014 : Cost Inflation Index: 2014-15 : 240; 2019-20: 289	₹28,00,000
(ii)	**Short Term:**	
	Sale proceeds of equity shares of Company A (January 2020): (STT paid on Company A shares)	₹13,50,000
	Cost of acquisition (August, 2019) :	₹5,50,000
	Sale proceeds of equity shares of Company B (December, 2019)	₹9,25,000
	Cost of acquisition (April, 2019) : (STT not paid on Company B Shares)	₹4,85,000

Compute the taxable income of SOL Inc and tax liability for the assessment year 2020-21 as per applicable provisions of the Income-tax Act, 1961, assuming that no other income is derived by SOL Inc (FII) during the financial year 2019-20.

Answer

(a) Computation of total income of SOL Inc., a notified FII, for A.Y.2020-21

Particulars	₹	₹
Investment Income		
Dividend income of ₹ 3,50,000 [Exempt under section 10(34)]	Nil	

Income in respect of securities [₹ 28,50,000 – Dividend ₹3,50,000]	25,00,000	25,00,000
[No deduction is allowable in respect of expenses incurred in respect thereof]		
Long-term capital gains on sale of securities		
Sale consideration	52,00,000	
Less: Cost of acquisition	28,00,000	
[Benefit of indexation is not allowable]		24,00,000
Short-term capital gains on sale of STT paid equity shares of Company A		
Sale consideration	13,50,000	
Less: Cost of acquisition	5,50,000	8,00,000
Short-term capital gains on sale on equity shares of Company B in respect of which STT is not paid		
Sale consideration	9,25,000	
Less: Cost of acquisition	4,85,000	
		4,40,000
Total Income		**61,40,000**

Computation of tax liability of SOL Inc. for A.Y.2020-21

Particulars	₹
Tax@5% on interest on ₹ 16,00,000 received from an Indian company on investment in rupee denominated bonds = 5% of ₹16,00,000	80,000
Tax@20% on balance investment income of ₹ 9,00,000 [₹ 25,00,000 – ₹16,00,000]	1,80,000
Tax@10% on long-term capital gains = 10% of ₹24,00,000	2,40,000
Tax@15% on STT paid short-term capital gains on sale of listed equity shares of Company A = 15% of ₹ 8,00,000	1,20,000
Tax@30% on short-term capital gains on sale of listed equity shares of Company B on which STT is not paid = 30% of ₹ 4,40,000	1,32,000
	7,52,000
Add: Education cess @4%	30,080
Tax Liability	**7,82,080**

Note - The computation of total income and tax liability of an FII, whose income comprises solely of investment income and capital gains on sale of securities is governed by the provisions of section 115AD, as per which

- no deduction is allowable in respect of expenditure to earn investment income and
- benefit of indexation is not allowable in respect of long-term capital gains.

The rates at which tax is to be calculated in respect of investment income and capital gains are also provided in section 115AD.

Question 27

Examine in the context of provisions contained under the Income-tax Act, 1961, each of the following independent cases and state in brief whether there exists business connection in each of

the cases in India so as to bring the income earned, if any, to tax net in India :-

(i) ABC Ltd., a company resident in Dubai, had set-up a liaison office at Mumbai to receive trade inquiries from customers in India. The work of the liaison office is not only restricted to forwarding of the trade inquiries to ABC Ltd. but the liaison office also negotiates and enters into the contracts on behalf of ABC Ltd. with the customers in India.

(ii) XYZ Inc. a resident of USA, has set up a branch at Hyderabad for the purpose of purchase of raw materials for manufacturing its products. The branch office is also engaged in selling the products manufactured by XYZ Inc. and in providing sales related services to customers in India on behalf of XYZ Inc.

(iii) Mr. Rajesh, a resident in India and based at Delhi, is appointed as an agent by PQR Inc. a company incorporated in UK for tracking the Indian markets. He was canvassing the orders and then communicating to PQR Inc. in UK. He had no authority to accept the orders. All the orders were directly received, accepted and after receipt of the price/value, the delivery of goods was given by PQR Inc. outside India. No purchase of raw material or manufacturing of finished goods took place in India. The agent was entitled to receive the commission on the sales so concluded by PQR Inc.

Answer

(i) If a Liaison Office is maintained solelyfor the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by the Reserve Bank of India, then, no business connection is established.
In this case, had the liaison office's activities been restricted to forwarding of trade inquiries to ABC Ltd., a Dubai based company, its activities would not have constituted business connection. However, the activities of the liaison office extends to also negotiating and entering into contracts on behalf of ABC Ltd. with the customers in India, on account of which business connection is established.

(ii) As per the opening sentence in Explanation 2, to section 9(1)(i) "business connection" shall include any business activity carried out through a person in India acting on behalf of the non-resident. Accordingly, in this case, since the branch office is carrying out a business activity by purchasing raw materials in India for XYZ Inc. and selling finished product manufactured by XYZ Inc. to customers in India and providing sales related services to them on behalf of XYZ Inc., business connection is established.

It may be noted that as per clause (a) of Explanation 2, in the case of a non- resident, no business connection would be established if the activities of the person acting on behalf of the non-resident were limited to the purchase of goods or merchandise for the non-resident.

In the present case, however, business connection would be established, since the branch set up at Hyderabad by XYZ Inc. is not solely engaged in purchase of raw materials for XYZ Inc. for manufacturing its products but is also engaged in selling such manufactured products to customers in India and providing sales related services to them on behalf of XYZ Inc.

(iii) 'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident. For a business connection to be established, the person acting on behalf of the non-resident –

a. must have an authority which is habitually exercised in India to conclude contracts on behalf of the non-resident or;

b. in a case where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, or

c. habitually secures orders in India, mainly or wholly for the non-resident.

In the present case, business connection would not be established, since Mr. Rajesh

does not have the authority to accept or conclude orders in India on behalf of PQR Inc. Moreover, all the orders were directly received, accepted and after receipt of the price/value, the delivery of goods was also given by PQR Inc. outside India. Hence, no business connection is established in this case.

Question 28

Mr. Rameshwarm, a non-resident Indian, acquired/purchased shares in foreign currency of a company XYZ Ltd. on 1.1.2010 for ₹ 10,00,000. These shares were sold by him in the recognized stock exchange through a broker (No STT paid) on 1.1.2019 for ₹ 30,00,000. The amount of sales consideration of the shares of ₹ 30,00,000 so received by him was again invested in purchase of shares of other company ABC Ltd. on 31.03.2019. The shares of ABC Ltd. purchased on 31.03.2019 were also sold by him on 30 06.2019 for ₹ 35,50,000.

Discuss the tax implications relating to the two transactions of sales of the shares in the relevant assessment years under the Income-tax Act, 1961 by ignoring the effect of first proviso to section 48.

Answer

In A.Y.2019-20, since Mr. Rameshwarm, has invested whole of the net consideration on transfer of a foreign exchange asset (being shares purchased in XYZ Ltd. in foreign currency), in shares of ABC Ltd., an Indian company, being a specified asset, within a period of six months, the long-term capital gain of ₹ 20,00,000 (₹ 30,00,000, being the sale consideration (-) ₹ 10,00,000, being the cost of acquisition) computed ignoring the effect of indexation, would not be chargeable to tax during the assessment year 2019-20, by virtue of the provisions of section 115F.

In A.Y. 2020-21, however, since Mr. Rameshwarm has sold the shares of ABC Ltd. within a period of three years, the amount not chargeable to tax in A.Y.2019-20 i.e., ₹ 20,00,000 would be chargeable to tax as long-term capital gains in the assessment year 2020-21, being the year of sale of such shares.

Further, short-term capital gain of ₹ 5,50,000 (₹ 35,50,000 - ₹ 30,00,000) would arise on transfer of shares of ABC Ltd., since such asset is held for a period of less than 12 months.

Question 29

Pranab, a non-resident Indian (aged 41) has furnished the following particulars of income relating to financial year 2019-20:

Particulars	₹
Loss from house property located in India	2,50,000
Income from business carried on in India	7,50,000
Income from mutual funds specified in section 10(23D)	65,000
Interest on debentures of Indian company subscribed in US$	1,50,000
Interest on loan taken for purchase of above debentures	20,000
Long-term capital gains on sale of debentures subscribed in US $ in the year 2010-11 for ₹ 5,00,000 and sold in the year 2019-20 for ₹ 8,00,000. (Cost Inflation Index- Financial Year 2010-11: 167; Financial Year 2019-20: 289)	
Brokerage on sale of debentures	12,000

Compute tax payable by Pranab for Assessment Year 2020-21, assuming that he opts for provisions of Chapter XII-A of the Income-tax Act, 1961.

Answer

Computation of tax payable by Mr. Pranab for A.Y. 2020-21

Particulars	₹	₹
Profit and gains of business or profession		
Income from business carried on in India	7,50,000	
Less: Loss from house property of ₹ 2,50,000, restricted to ₹ 2,00,000 by virtue of section 71(3A)	2,00,000	5,50,000
Balance loss of ₹ 50,000 [₹ 2,50,000 – ₹ 2,00,000] from house property to be carried forward to A.Y.2021-22.		
Capital Gains		
Long term capital gains		
Sale Consideration	8,00,000	
Less: Brokerage on sale of debentures	12,000	
Net sale consideration	7,88,000	
Less: Cost of acquisition [Indexation benefit would not be available for calculating cost of acquisition while computing long term capital gains under Chapter XII-A]	5,00,000	2,88,000
Income from Other Sources		
Income from mutual fund specified in section 10(23D) [Exempt under section 10(35)]	Nil	
Interest on debentures of Indian company [No deduction is allowed under any provision of the Act in respect of any expenditure or allowance while computing the interest on debentures applying the provisions under Chapter XII-A. Therefore, interest on loan taken for purchase of debenturesis not deductible].	1,50,000	1,50,000
Gross Total Income/ Total Income		**9,88,000**
Tax liability [as per provisions of Chapter XII-A]		
Tax on long term capital gains (₹ 2,88,000 x 10%)	28,800	
Tax on interest on debentures, being investment income (₹ 1,50,000 x 20%)	30,000	
Tax on balance income of ₹ 5,50,000 as per the normal provisions of the Act		
Upto ₹ 2,50,000 — Nil		
₹ 2,50,001 – ₹5,00,000 @5% — 12,500		
₹ 5,00,001 – ₹5,50,000@20% — 10,000	22,500	81,300
Add: Education cess @4%		3,252
Tax liability		**84,552**
Tax liability (rounded off)		**84,550**

Question 30

ABC Inc., a company incorporated in London has entered into an agreement with XYZ Limited, an Indian company for rendering technical services to the latter for setting up a steel plant in Madhya Pradesh. As per the agreement, ABC Inc. rendered both off-shore services and on-shore services to

XYZ Limited at fee of ₹ 75 lakhs and ₹ 90 lakhs, respectively. ABC Inc. is of the view that it is not liable to tax in India in respect of fee of ₹ 75 lakhs as it is for rendering services outside India. Discuss the correctness of the view of ABC Inc.

Answer

The Explanation to section 9(1) clarifies that income by way of, inter alia, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, ABC Inc., were for setting up a steel plant in Madhya Pradesh. Therefore, the services were utilized in India. Consequently, as per section 9(1)(vii) read with the above Explanation, the fee of ₹ 1.65 crore for technical services rendered by ABC Inc (both off-shore and on-shore services) to XYZ Ltd. is deemed to accrue or arise in India and includible in the total income of ABC Inc.

Therefore, the view of ABC Inc. that it is not liable to tax in India in respect of fee of ₹ 75 lakh (as it is for rendering services outside India) is not correct.

Question 31

John Butler Tex. Inc., is a company incorporated in Colombo, Sri Lanka. 60% of its shares are held by I Pvt. Ltd., a domestic company. John Butler Tex. Inc. has its presence in India also. The data relating to John Butler Tex. Inc., are as under:

Particulars	India	Sri Lanka
Fixed assets at depreciated values for tax purposes (₹ in crores)	90	70
Intangible assets (₹ in crores)	40	180
Other assets (₹ in crores)	30	90
Income from trading operations (₹ in crores)	15	42
Income from investments (₹ in crores)	30	13
Number of employees (Residents in respective countries)	40	60

For POEM purposes, state whether,

(i) The company shall be said to be engaged in 'active business outside India'.

(ii) Because of increased operations in India, more manpower is needed. 30 more employees may be required in this regard. The company can either take these employees directly in its roll or can outsource the increased operation to an external agency which will engage the 15 employees in its roll and finish the work for the company. Which choice will be better?

Note: If for any test, average figures are needed, the same may be ignored and the data as given above to the applicant may be used.

Answer

(i) For determining the POEM of a company, the important criteria is whether the company is engaged in active business outside India or not.

A company shall be said to be engaged in "**Active Business Outside India**" (ABOI) for POEM, if

- the passive income is not more than 50% of its total income; **and**
- less than 50% of its total assets are situated in India; **and**
- less than 50% of total number of employees are situated in India or are resident in

India; **and**

- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

John Butler Tex. Inc. shall be regarded as a company engaged in active business outside India for P.Y. 2019-20 for POEM purpose only if it satisfies all the four conditions cumulatively.

Condition 1: The passive income of John Butler Tex. Inc. should not be more than 50% of its total income

Total income of John Butler Tex. Inc. during the P.Y.2019-20 is ₹ 100 crores [(₹ 15 crores + ₹30 crores) + (₹ 42 crores + ₹13 crores)]

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest or rental income;

Passive Income of John Butler Tex. Inc. is ₹ 43 crores, being income from investment of ₹ 30 Crores in India and ₹ 13 crores in Sri Lanka.

Percentage of passive income to total income = ₹ 43 crore/ ₹ 100 crore x 100 = 43%

Since passive income of John Butler Tex. Inc. is 43% i.e., is not more than 50% of its total income, the first condition is satisfied.

Condition 2: John Butler Tex. Inc. should have less than 50% of its total assets situated in India

Value of total assets of John Butler Tex. Inc. during the P.Y. 2019-20 is ₹ 500 crores [₹ 160 crores, in India + ₹ 340 crores, in Sri Lanka].

Value of total assets of John Butler Tex. Inc. in India during the P.Y. 2019-20 is ₹ 160 crores.

Percentage of assets situated in India to total assets = ₹ 160 crores/₹ 500 crores x 100 = 32%

Since the value of assets of John Butler Tex. Inc. situated in India is less than 50% of its total assets, the second condition for ABOI test is satisfied.

Condition 3: Less than 50% of the total number of employees of John Butler Tex. Inc. should be situated in India or should be resident in India

Number of employees situated in India or are resident in India is 40 Total number of employees of John Butler Tex. Inc. is 100 [40 + 60]

Percentage of employees situated in India or are resident in India to total number of employees is 40/100 x 100 = 40%.

Since employees situated in India or are residents in India of John Butler Tex. Inc. are less than 50% of its total employees, the third condition for ABOI test is satisfied.

Condition 4: The payroll expenses incurred on employees situated in India or residents in India should be less than 50% of its total payroll expenditure

Since the information pertaining to payroll expenditure of employees situated in India and situated outside India is not given in the question it is assumed that the condition pertaining to payroll expenditure is also satisfied by John Butler Tex. Inc.

Thus, since the John Butler Tex. Inc. has satisfied all the four conditions, the company would be said to be engaged in "active business outside India".

Note – Since the information pertaining to payroll expenditure of employees situated in India and situated outside India is not given in the question it is also possible to assume that the

condition pertaining to payroll expenditure is not satisfied by John Butler Tex. Inc.

In such case, the company would not be said to be engaged in "active business outside India", since John Butler Tex. Inc. has not satisfied one of condition i.e., payroll expenditure out of the specified four conditions.

(ii) Option 1: 30 more employees employed in India for the increased operations

In case John Butler Tex. Inc. employed 30 more employees in India, then Percentage of employees situated in India or are resident in India to total number of employees would be 70/130 x 100 = 53.85%.

In such a case, one of the four conditions would not be satisfied and therefore, John Butler Tex. Inc. would not be considered to be engaged in ABOI.

It may be noted that place of effective management of a company passing the ABOI test would be presumed to be outside India, if majority of the board meetings are held outside India. Consequently, the global income of the company would not be subject to tax in India. However, such a presumption cannot be made if the company does not fulfil any of the four conditions for ABOI.

Option 2: Increased operations outsourced to external agency which will get the work done by engaging 15 employees in India

For the purpose of ABOI, employees shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees.

Thus, 15 employees engaged by external agency have also to be included while determining the percentage of employees situated in India or are resident in India to the total number of employees.

In such a case, the percentage of employees situated in India or are resident in India to total number of employees would be 55/115 x 100 = 47.83%

In such a case, John Butler would continue to satisfy the four conditions for ABOI. Thus, it would be better to outsource the increased operation to an external agency.

Question 32

Mr. Robert, a non-resident, (aged 38) operates a ship for the carriage of goods, passengers and livestock between Dubai, Mumbai and Chennai. He provides you the following particulars for the previous year 2019-20:

(i) Received ₹ 200 Lakhs in India on account of carriage of livestock from Mumbai to London.

(ii) Received ₹ 50 Lakhs in India on account of carriage of passengers from Dubai to Colombo.

(iii) Received ₹ 65 Lakhs in Dubai on account of carriage of goods from Chennai to Dubai.

(iv) Expenses incurred during the year in respect of operation of such ships ₹ 195 Lakhs.

(v) Winning from horse races in India ₹ 25 Lakhs

Compute the total income of Mr. Robert Chargeable to tax in India for the assessment year 2020-21. Also, calculate the tax payable thereon.

Answer

Computation of total income and tax payable by Mr. Robert

	Amount (₹)
Section 44B provides that profits and gains of a non-resident engaged in the business of operation of ships are to be taken @7.5% of the aggregate of the following amounts:	

(i) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of carriage of passengers, livestock, mail or goods shipped at any port in India; and (ii) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India. These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A. Accordingly, profits from shipping business of Mr. Robert computed as follows:		
(i) Amount received in India on account of carriage of livestock from Mumbai to London		200 lakhs
(ii) Amount received in India on account of carriage of passengers from Dubai to Colombo		50 lakhs
(iii) Amount received in Dubai on account of carriage of goods from Chennai to Dubai		65 lakhs
Total amount received		**315 lakhs**
Profits and gains chargeable under head profits and gains from business or profession @7.5% of the total amount received		**23,62,500**
Income from other sources		
Winning from horse races in India [assumed to be the gross amount]		25,00,000
Total Income		**48,62,500**
Tax on winning from horse races @ 30%		7,50,000
Tax on balance income of ₹ 23,62,500		
Upto ₹ 2,50,000	Nil	
₹ 2,50,001 – ₹5,00,000	12,500	
₹ 5,00,001 – ₹10,00,000	1,00,000	
₹ 10,00,001 – ₹23,62,500	4,08,750	5,21,250
		12,71,250
Add: Health and Education Cess @4%		50,850
Tax liability		**13,22,100**
Less: Tax deduction at source on winnings from horse races [31.2% of ₹ 25,00,000]		7,80,000
Tax payable [See Note below]		**5,42,100**

Note: The tax payable would get further reduced by the amount of tax paid under section 172(4). The amount of tax payable under section 172 would be 41.6% (being the rate applicable to a foreign company) of 7.5% of ₹ 265 lakhs (being the amounts payable for goods shipped at a port in India) = ₹ 8,26,800. After reducing this amount, the tax refundable on total income would be ₹ 2,84,700.

Question 33

(i) Xylo Inc., a US company, received income by way of fees for technical services of ₹2 crore from Alpha Ltd., an Indian company, in pursuance of an agreement between Alpha Ltd. and Xylo Inc. entered into in the year 2012, which is approved by the Central Government. Expenses incurred for earning such income is ₹ 8 lakhs. Examine the taxability of the above sum in the hands of Xylo Inc as per the provisions of the Income-tax Act, 1961 and the requirement, if any,

to file return of income, assuming that Xylo Inc does not have a permanent establishment in India

(ii) If Xylo Inc. has a permanent establishment in India and the contract/agreement with Alpha Ltd. for rendering technical services is effectively connected with such PE in India, examine the taxability based on the following details provided –

	Particulars	Amount
(1)	Fees for technical services received from Alpha Ltd.	₹ 2 crore
(2)	Expenses incurred for earning such income	₹ 8 lakhs
(3)	Fees for technical services received from other Indian companies in pursuance of approved agreement entered into between the years 2005 to 2010	₹ 4 crore
(4)	Expenses incurred for earning such income	₹ 15 lakhs
(5)	Expenditure not wholly and exclusively incurred for the business of such PE [not included in (2) & (4) above]	₹ 6 lakhs
(6)	Amounts paid by the PE to Head Office (not being in the nature of reimbursement of actual expenses)	₹ 12 lakhs

What are the other requirements, if any, under the Income-tax Act, 1961 in this case?

Answer

(i) <u>Where Xylo Inc., a US company, does not have a PE in India</u>

In this case, Xylo Inc. would be eligible for a concessional rate of tax@10% of ₹ 2 crore under section 115A on the fees for technical services received from Alpha Ltd., an Indian company, since the same is in pursuance of an agreement entered into after 31.3.1976, which has been approved by the Central Government. No deduction, however, would be allowed in respect of expenditure of ₹ 8 lakhs incurred to earn such income. Also, Xylo Inc. has to file its return of income in India under section 139 and there is no exemption in this regard.

(ii) <u>Where Xylo Inc., a US company, has a PE in India and rendering technical services is effectively connected with the PE in India.</u>

Since Xylo Inc. carries on business through a PE in India, in pursuance of an agreement with Alpha Ltd. or other Indian companies entered into after 31.3.2003, and the income by way of fees for technical services is effectively connected with the PE in India as per section 44DA, such income shall be computed under the head "Profits and gains of business or profession" in accordance with the provisions of the Income-tax Act, 1961.

Accordingly, expenses of ₹ 23 lakhs (₹ 8 lakhs + ₹ 15 lakhs) incurred for earning fees for technical services of ₹ 6 crore (₹ 2 crore + ₹ 4 crore) is allowable as deduction therefrom. However, expenditure of ₹ 6 lakhs which is not incurred wholly and exclusively for the business of the PE and the amount of ₹ 12 lakhs paid by the PE to the Head Office is **<u>not</u>** allowable as deduction.

Xylo Inc. is required to maintain books of account under section 44AA and get the same audited under section 44AB and furnish report along with the return of income u/s 139.

Question 34

The following data is furnished by Mr. Sumedh, a non-resident and a person of Indian Origin, for the financial year ended 31-3-2020:

A:	Long-term capital gains arising on transfer of foreign exchange asset on 31.7.2019 (computed)	₹ 6,50,000
	Expenditure wholly and exclusively incurred in connection with such transfer (not considered above)	₹ 80,000
	Interest on deposits held with private limited companies	₹ 5,90,000

	Interest on Government Securities	₹ 95,000
	Interest on deposits with pubic limited companies	₹ 2,60,000
	Dividends from Domestic Companies	₹ 75,000
B:	Savings and Investments	
	Investment in notified savings certificates referred to in section 10(4B) on 30.3.2020	₹ 2,00,000
	Investment in shares of Indian public limited companies on 31.12.2020	₹ 3,00,000
C:	Tax deducted at source	₹ 1,83,000

Compute balance tax payable / refund due for the assessment year 2020-21 in accordance with special provisions applicable to non-residents.

Answer

Computation of tax payable/refund due to Mr. Sumedh for A.Y.2020-21

Particulars	₹	₹
Capital Gains		
Long-term capital gains on transfer of foreign exchange asset on 31.7.2019	6,50,000	
Less: Expenditure wholly and exclusively incurred with such transfer	80,000	5,70,000
Less: **Exemption under section 115F**		
- Investment of ₹ 2,00,000 in notified saving certificates referred to in section 10(4B) on 30.3.2020 [Investment in notified saving certificates referred to in section 10(4B) is to be made within six months after the date of transfer i.e., on or before 31.1.2020. Since investment is made after 31.1.2020, no exemption would be allowed]	Nil	
- Investment of ₹ 3,00,000 in shares of Indian Public Limited Companies on 31.12.2020 [Investment in specified assets, being shares in an Indian company is to be made within six months after the date of transfer i.e., on or before 31.1.2020. Since investment is made after 31.1.2020, no exemption would be allowed]	Nil	Nil
		5,70,000
Income from other sources		
Investment Income		
Interest on Government Securities 95,000		
Interest on deposits with public limited companies 2,60,000	3,55,000	
Other Incomes		
Dividend from domestic companies of ₹ 75,000 [Exempt under section 10(34)]	Nil	
Interest on deposits with private limited companies	5,90,000	
		9,45,000
Total Income		**15,15,000**
Particulars	**₹**	**₹**
Tax liability [applying the special provisions under Chapter XII-A]		
Tax@20% on investment income = 20% of ₹3,55,000	71,000	

Tax@10% on long-term capital gains = 10% of ₹5,70,000	57,000	
Tax on balance income of ₹ 5,90,000 at slab rate [₹ 18,000, being 20% of ₹90,000 + ₹12,500]	30,500	
		1,58,500
Add: Health and education cess@4%		6,340
Tax liability		**1,64,840**
Less: TDS		1,83,800
Refund due		**18,960**

Question 35

State with reasons whether the following income of the non-resident is deemed to accrue or arise in India:

(1) M/s XYZ Highway Ltd, a resident Indian company is engaged in the business of building highway projects in India. It has borrowed US $ 250 million from a financial institution resident in US to invest in one of its ongoing projects in India. The rate of interest charged is 8% p.a. Assume 1 US$ = ₹ 69.
Will your answer differ in case the money is invested in one of its ongoing projects in Sri Lanka?

(2) Mr. A a non-resident, staying in England, holds 10% of the total share capital in M/s ABC Ltd. a company incorporated in England. M/s ABC Ltd. directly owns assets in India. Mr. A has transferred his entire share capital to Mr. B an Indian resident when he was in England.

Answer

(1) As per section 9(1)(v)(b), interest payable by a person resident in India would be deemed to accrue or arise in India. However, such interest would not be deemed to accrue or arise in India if the interest is payable in respect of moneys borrowed and used, inter alia, for the purpose of business or profession carried on by such resident outside India.

In the present case, if M/s XYZ Highway Ltd. has used the money borrowed for its projects in India, interest received by financial institution resident in US would be deemed to accrue or arise in India.

If, M/s XYZ Highway Ltd. used the money borrowed for its projects in Sri Lanka i.e., for business outside India, it would be covered under the exception and the interest received by financial institution resident in US would not be deemed to accrue or arise in India.

(2) As per section 9(1)(i), income arising through the transfer of a capital asset situated in India would be deemed to accrue or arise in India. As per Explanation 5 to section 9(1)(i), shares in a company registered outside India would be deemed to be situated in India, if the shares derive, directly or indirectly, its value substantially from assets located in India.

However, income from transfer of such shares would not be deemed to accrue or arise in India if such company directly owns assets in India and the transferor neither holds the right of management or control in such company nor holds more than 5% of the total share capital of such company [As per Explanation 7 to section 9(1)(i)].

In the present case, M/s ABC Ltd. is a company incorporated in England which directly owns assets in India. However, since Mr. A holds more than 5% of the total share capital of M/s ABC Ltd, capital gain arising from the transfer of shares of M/s ABC Ltd would be deemed to accrue or arise in India in the hands of Mr. A.

Question 36

ABC Ltd, a software giant in India, set up a 100% subsidiary company by name SHD Inc. in Switzerland on 1st April, 2019. The subsidiary company, SHD Inc., is mainly engaged in the software services, hardware services and data backup services in three different countries viz., Switzerland, Sweden and India. The following information is furnished by SHD Inc., for FY 2019-20:

Particulars	In Switzerland	In Sweden	In India
Value of assets as per books of account (₹ in crores)	24	12	24
Number of employees working (in thousands)	30	10	28
Pay roll expenditure (₹ in crores)	4	2.6	5.4
Total aggregate income earned	₹ 80 crores		

Other Information:

I. Break up of total income:

- ₹ 28 crores derived from the transactions where purchases are made from associated enterprises and sold to non-associated enterprises;
- ₹ 24 crores derived from the transactions where both purchases and sales are made from/to associated enterprises;
- ₹ 16 crores derived from the transactions where purchases are made from non-associated enterprises and sold to associated enterprises:
- ₹ 8 crores by way of income from capital gains on trading of shares;
- ₹ 4 crores by way of interest from non-associated enterprises;

II. During FY 2019-20, total 5 board meetings were held, 2 in India, 1 in Sweden and 2 in Switzerland.

Based on the above information, determine the residential status of SHD Inc., applying the provisions of POEM for the A.Y.2020-21.

Answer

SHD Inc., a foreign company, would be resident in India in the P.Y. 2019-20, if its place of effective management is in India in that year.

For determining the POEM of SHD Inc., the important criteria is whether the company is engaged in active business outside India or not.

A company shall be said to be engaged in "**Active Business Outside India"** (ABOI) for POEM, if

- the passive income is not more than 50% of its total income; **and**
- less than 50% of its total assets are situated in India; **and**
- less than 50% of total number of employees are situated in India or are resident in India; **and**
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

SHD Inc. would be regarded as a company engaged in active business outside India for P.Y. 2019-20 for POEM purpose only if it satisfies all the four conditions cumulatively.

Condition 1: The passive income of SHD Inc. should not be more than 50% of its total income

Total income of SHD Inc. during the P.Y. 2019-20 is ₹ 80 crores.

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises i.e., ₹ 24 crores; and

(ii) income by way of, inter alia, capital gains i.e., ₹ 8 crores and interest i.e., ₹ 4 crores;

Passive Income of SHD Inc. is ₹ 36 crores

Percentage of passive income to total income = ₹ 36 crore/ ₹ 80 crore x 100 = 45% Since passive income of SHD Inc. i.e., 45% is not more than 50% of its total income, the first condition is satisfied.

Condition 2: SHD Inc. should have less than 50% of its total assets situated

Value of total assets of SHD Inc. is ₹ 60 crores [₹ 24 crore + ₹ 12 crore + ₹ 24 crore].

Value of total assets of SHD Inc. in India is ₹ 24 crores

Percentage of assets situated in India to total assets = ₹ 24 crores/₹ 60 crores x 100 = 40%

Since the value of assets of SHD Inc. situated in India is less than 50% of its total assets, the second condition for ABOI test is satisfied.

Condition 3: Less than 50% of the total number of employees of SHD Inc. should be situated in India or should be resident in India

Number of employees working in India is 28,000.

Total number of employees of SHD Inc. is 68,000 [30,000+10,000+28,000].

Percentage of employees working in India to total number of employees is 28,000 x 100/68,000 = 41.176%

Since employees of SHD Inc. working in India are less than 50% of its total employees, the third condition for ABOI test is satisfied.

Condition 4: The payroll expenses incurred on employees situated in India or resident in India should be less than 50% of its total payroll expenditure

Payroll expenditure on employees in India is ₹ 5.40 crores

Total payroll expenditure of SHD Inc. is ₹ 12 crores [4.0 crore + 2.6 crore + 5.4 crore].

Percentage of payroll expenditure on employees in India to total payroll expenditure is ₹ 5.4 crores/₹12 crores x 100 = 45%

Since payroll expenditure on employees of SHD Inc. in India is less than 50% of its total payroll expenditure, the fourth condition for ABOI test is satisfied.

Since SHD Inc. satisfies all the above four conditions cumulatively, SHD Inc. has passed the Active Business Outside India (ABOI) test.

Determination of POEM of SHD Inc.

POEM of a company engaged in active business outside India shall be presumed to be outside India, if the majority of the board meetings are held outside India.

Since SHD Inc. is engaged in active business outside India in P.Y. 2019-20 and majority of its board meetings i.e., 3 out of 5, were held outside India, POEM of SHD Inc. would be outside India.

Therefore, SHD Inc. would be non-resident in India for the P.Y. 2019-20.

Question 37

Singtel Ltd. is a company incorporated in Singapore and 55% of its shares are held by Godavari (P) Ltd., an Indian company. Singtel Ltd. has its presence in India also. The details relating to Singtel Ltd. for the P.Y.2019-20, are as under:

Particulars	India	Singapore
Fixed assets at depreciated values for tax purposes (₹in crores)	120	80

Intangible assets (₹in crores)		50	200
Other assets (value as per books of account) (₹in crores)		40	120
Income from trading operations (₹in crores)		25	50
The above figure includes:			
(i)	Income from transactions where purchases are from associated enterprises	2	4
(ii)	Income from transactions where sales are to associated enterprises	3	5
(iii)	Income from transactions where both purchases and sales are from/to associated enterprises	5	10
Interest and dividend from investments (₹in crores)		20	15
Number of employees (Residents in respective countries)		70	90
Payroll expenses on employees (₹in crores)		8	12

Determine the residential status of Singtel Ltd. for A.Y.2020-21, if during the F.Y.2019-20, seven board meetings were held – 3 in India and 4 in Singapore.

Answer

The residential status of a foreign company is determined on the basis of place of effective management (POEM) of the company.

For determining the POEM of a foreign company, the important criteria is whether the company is engaged in active business outside India or not.

A company shall be said to be engaged in "**Active Business Outside India"** (ABOI) for POEM, if

- the passive income is not more than 50% of its total income; **and**
- less than 50% of its total assets are situated in India; **and**
- less than 50% of total number of employees are situated in India or are resident in India; **and**
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Singtel Ltd. shall be regarded as a company engaged in active business outside India for P.Y.2019-20 for POEM purpose only if it satisfies all the four conditions cumulatively.

Condition 1: The passive income of Singtel Ltd. should not be more than 50% of its total income

Total income of Singtel Ltd. during the P.Y. 2019-20 is ₹ 110 crores [(₹ 25 crores + ₹ 50 crores) + (₹ 20 crores + ₹15 crores)]

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest or rental income;

Passive Income of Singtel Ltd. is ₹ 50 crores, being sum total of :

(i) ₹ 15 crores, income from transactions where both purchases and sales are from/to associated enterprises (₹ 5 crores in India and ₹ 10 crores in Singapore)

(ii) ₹ 35 crores, being interest and dividend from investment (₹ 20 crores in India and ₹ 15 crores in Singapore)

Percentage of passive income to total income = ₹ 50 crore/ ₹ 110 crore x 100 = 45.45%

Since passive income of Singtel Ltd. **is 45.45%, which is not more than 50%** of its total income, the first condition is satisfied.

Condition 2: Singtel Ltd. should have less than 50% of its total assets situated in India

Value of total assets of Singtel Ltd. during the P.Y. 2019-20 is ₹ 610 crores [₹ 210 crores, in India + ₹ 400 crores, in Singapore]

Value of total assets of Singtel Ltd. in India during the P.Y. 2019-20 is ₹ 210 crores

Percentage of assets situated in India to total assets = ₹ 210 crores/₹ 610 crores x 100 = 34.43%

Since the value of assets of Singtel Ltd. **situated in India is less than 50%** of its total assets, the second condition for ABOI test is satisfied.

Condition 3: Less than 50% of the total number of employees of Singtel Ltd. should be situated in India or should be resident in India

Number of employees situated in India or are resident in India is 70 Total number of employees of Singtel Ltd. is 160 [70 + 90]

Percentage of employees situated in India or are resident in India to total number of employees is 70/160 x 100 **= 43.75%**

Since employees situated in India or are residents in India of Singtel Ltd. **are less than 50%** of its total employees, the third condition for ABOI test is satisfied.

Condition 4: The payroll expenses incurred on employees situated in India or resident in India should be less than 50% of its total payroll expenditure

Payroll expenses on employees employed in and resident of India = ₹ 8 crores. Total payroll expenses = ₹ 20 crores (₹ 8 crores + ₹12 crores)

Percentage of payroll expenses of employees situated in India or are resident in India to the total payroll expenses = 8 x 100/20 = 40%

Since the payroll expenses incurred on employees situated in India or resident in India **is less than 50% of its total payroll expenditure**, the fourth condition for ABOI test is also satisfied.

Thus, since Singtel Ltd. has satisfied all the four conditions, the company would be said to be engaged in "active business outside India" during the P.Y.2019-20.

POEM of a company engaged in active business outside India shall be presumed to be outside India, if the majority of the board meetings are held outside India.

Since Singtel Ltd. is engaged in active business outside India in P.Y. 2019--20 and majority of its board meetings i.e., 4 out of 7, were held outside India, POEM of Singtel Ltd. would be outside India.

Therefore, Singtel Ltd. would be non-resident in India for the P.Y.2019-20.

CHAPTER - 3
Double Taxation Relief

Section A – ICAI Study Material Questions

Question 1

Examine the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 1961.

The double taxation avoidance treaties entered into by the Government of India override the domestic law.

Answer

The statement is correct.

Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee [CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)].

Question 2

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of ₹ 1,10,000 from theatrical works played abroad. Tax of ₹ 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to ₹ 6,10,000. In view of tax planning, she has deposited ₹ 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC ₹ 32,000. She also contributed ₹ 28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of ₹ 26,000 to insure the health of her father, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2020-21.

Answer

Computation of tax liability of Nandita for the A.Y. 2020-21

Particulars	₹	₹
Indian Income		6,10,000
Foreign Income		1,10,000
Gross Total Income		**7,20,000**
Less: Deduction under section 80C		
Deposit in PPF	1,50,000	
Under section 80CCC		
Contribution to approved Pension Fund of LIC	32,000	
	1,82,000	
Under section 80CCE		
The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1,50,000	1,50,000	

Under section 80D		
Contribution to Central Government Health Scheme ₹ 28,000 is also allowable as deduction under section 80D. Since she is a resident senior citizen, the deduction is allowable to a maximum of ₹ 50,000 **(See Note 1)**	28,000	
Medical insurance premium of ₹ 26,000 paid for father aged 84 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of ₹ 50,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ₹ 25,000.	25,000	2,03,000
Total Income		**5,17,000**
Tax on Total Income		
Income-tax (See Note below)		13,400
Add: Health and Education Cess @4%		536
		13,936
Average rate of tax in India (i.e. ₹ 13,936/ ₹5,17,000 × 100)	2.696%	
Average rate of tax in foreign country (i.e. ₹ 11,000/ ₹1,10,000 ×100)	10%	
Deduction under section 91 on ₹ 1,10,000 @ 2.696% (lower of average Indian-tax rate or average foreign tax rate)		2,966
Tax payable in India (₹ 13,936 – ₹ 2,966)		**10,970**

Notes:

1. Section 80D allows a higher deduction of up to ₹ 50,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, Nandita will be allowed deduction of ₹ 28,000 under section 80D, since she is a resident Indian of the age of 60 years.
2. The basic exemption limit for senior citizens is ₹ 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Nandita is eligible for the higher basic exemption limit of ₹ 3,00,000, since she is 60 years old.
3. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-
   (a) The assessee is a resident in India during the relevant previous year.
   (b) The income accrues or arises to him outside India during that previous year.
   (c) Such income is not deemed to accrue or arise in India during the previous year.
   (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
   (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

   In this case, since all the above conditions are satisfied, Nandita is eligible for deduction u/s 91.

Question 3

Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2019. The Indian branch has filed return of income for assessment year 2020-21 disclosing income of ₹ 50 lacs. It paid tax at the rate applicable to domestic company i.e. 30% plus higher

education cess@4% on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:

"The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus higher education cess@4%.

Is the action of the Assessing Officer in accordance with law?

Answer

Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of Article 24 (Non-discrimination of the DTAA, it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, Explanation 1 to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this Explanation, the action of the Assessing Officer in levying tax@40% on the Indian branch of Cosmos Ltd. is in accordance with law.

Question 4

Kalpesh Kumar, a resident individual, is a musician deriving income of ₹ 7,50,000 from concerts performed outside India. Tax of ₹ 1,00,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to ₹ 30,00,000. Compute tax liability of Kalpesh Kumar for the assessment year 2020-21 assuming he has deposited ₹ 1,50,000 in Public Provident Fund and paid medical insurance premium in respect of his father, resident in India, aged 65 years, ₹ 52,000.

Answer

Computation of tax liability of Mr. Kalpesh for A.Y.2020-21

Particulars	₹	₹
Indian Income		30,00,000
Foreign Income		7,50,000
Gross Total Income		**37,50,000**
Less: **Deduction under section 80C**		
PPF Contribution	1,50,000	
Deduction under section 80D		
Medical insurance premium of father, being a resident senior citizen, restricted to	50,000	2,00,000
Total Income		**35,50,000**

Tax on total income		8,77,500
Add: Health and Education cess @4%		35,100
		9,12,600
Average rate of tax in India [i.e., ₹ 9,12,600 /₹ 35,50,000 x 100]	25.71%	
Average rate of tax in foreign country [i.e. ₹ 1,00,000/ ₹7,50,000 x 100]	13.333%	
Doubly taxed income	7,50,000	
Deduction under section 91 on ₹ 7,50,000 @13.33% (lower of average Indian tax rate and foreign tax rate]		1,00,000
Tax payable in India [₹ 9,12,600 – ₹ 1,00,000]		**8,12,600**

Note: An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, Kalpesh Kumar is eligible for deduction under section 91 since all the above conditions are fulfilled.

Question 5

The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the assessment year 2020-21:

	(₹ In lacs)
Income from playing snooker matches in country L	12.00
Tax paid in country L	1.80
Income from playing snooker tournaments in India	19.20
Life Insurance Premium paid	1.10
Medical Insurance Premium paid for her father aged 62 years (paid through credit card)	0.54

Compute her total income and tax liability for the assessment year 2020-21. There is no Double Taxation Avoidance Agreement between India and country L.

Answer

Computation of total income and tax liability of Miss Vivitha for the A.Y. 2020-21

Particulars	**₹**	**₹**
Indian Income [Income from playing snooker tournaments in India]		19,20,000
Foreign Income [Income from playing snooker matches in country L]		12,00,000
Gross Total Income		**31,20,000**
Less: Deduction under Chapter VIA		
Deduction under section 80C		

Life insurance premium of ₹ 1,10,000 paid during the previous year deduction, is within the overall limit of ₹ 1.5 lakh. Hence, fully allowable as deduction	1,10,000	
Deduction under section 80D		
Medical insurance premium of ₹ 54,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of ₹ 50,000 (assuming that her father is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.	50,000	1,60,000
Total Income		**29,60,000**
Tax on Total Income		
Income-tax		7,00,500
Add: Health and education cess @4%		28,020
		7,28,520
Average rate of tax in India	24.61%	
(i.e. ₹ 7,28,520/₹29,60,000 × 100)		
Average rate of tax in foreign country	15.00%	
(i.e. ₹ 1,80,000/ ₹12,00,000 ×100)		
Deduction under section 91 on ₹ 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)		1,80,000
Tax payable in India (₹ 7,28,520 – ₹1,80,000)		**5,48,520**

Note: Miss Vivitha shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) She is a resident in India during the relevant previous year.

(b) The income accrues or arises to her outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign country L in her hands and she has paid tax on such income in the foreign country L.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country L where the income has accrued or arisen.

Question 6

The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Examine the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).

Answer

Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

As per section 92F(iiia), the term "Permanent Establishment" includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs however provide that business income is taxable only if there is a permanent establishment in India.

Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

Question 7

An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to examine whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.

Answer

The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, **a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal.** Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of section 91 read with Rule 128 on Foreign Tax Credit.

Question 8

The Income-tax Act, 1961 provides for taxation of a certain income earned in India by Mr. X, a non-resident. The Double Taxation Avoidance Agreement, which applies to Mr. X provides for taxation of such income in the country of residence. Is Mr. X liable to pay tax on such income earned by him in India? Examine.

Answer

Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then **in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee.** This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

However, as per section 90(4), the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide the following information in Form No. 10F:

(i) Status (individual, company, firm etc.) of the assessee;

(ii) PAN of the assessee, if allotted;

(iii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iv) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is

(v) identified by the Government of the country or the specified territory of which the assessee claims to be a resident;

(vi) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(vii) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (v) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The Supreme Court has held, in CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654, that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961. Mr. X is, therefore, not liable to pay tax on the income earned by him in India provided he submits the Tax Residence Certificate obtained from the government of the other country, and provides such other documents and information as may be prescribed.

Question 9

Arif is a resident of both India and another foreign country in the previous year 2019-20. He owns immovable properties (including residential house) in both the countries. He earned income of ₹ 50 lacs from rubber estates in the foreign country during the financial year 2019-20. He also sold some house property situated in foreign country resulting in short-term capital gain of ₹ 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of ₹ 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that "where an individual is a resident of both the Contracting States, then, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)".

You are required to examine with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

Answer

Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply

to the extent they are more beneficial to that assessee.

Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with foreign country provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –

(a) the property is located and
(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2020-21.

The fact of the case and issues arising therefrom are similar to that of CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654, where the Supreme Court held that if an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2020-21 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

Question 10

Mr. Kamesh, an individual resident in India aged 52 years, furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2019-20. India has not entered into double taxation avoidance agreement with these two countries.

Particulars	₹
Income from profession carried on in India	7,50,000
Agricultural income in Country "X" (gross)	50,000
Dividend received from a company incorporated in Country "Y" (gross)	1,50,000
Royalty income from a literary book from Country "X" (gross)	6,00,000
Expenses incurred for earning royalty	50,000
Business loss in Country "Y" (Proprietary business)	65,000
Rent from a house situated in Country "Y" (gross)	2,40,000
Municipal tax paid in respect of the above house in Country “Y” (not allowed as deduction in country “Y”)	10,000

Note: Business loss in Country "Y" not eligible for set off against other incomes as per law of that country. The rates of tax in Country "X" and Country "Y" are 10% and 20%, respectively.

Compute total income and tax payable by Mr. Kamesh in India for Assessment Year 2020-21.

Answer

Computation of total income of Mr. Kamesh for A.Y.2020-21

Particulars	₹	₹
Income from House Property [House situated in country Y]		
Gross Annual Value[1]	2,40,000	
Less: Municipal taxes	10,000	
Net Annual Value	2,30,000	
Less: Deduction under section 24 – 30% of NAV	69,000	
		1,61,000
Profits and Gains of Business or Profession		
Income from profession carried on in India	7,50,000	
Royalty income from a literary book from Country X (after deducting expenses of ₹ 50,000)	5,50,000	
Less: Business loss in country Y set-off[2]	65,000	
		12,35,000
Income from Other Sources		
Agricultural income in country X	50,000	
Dividend received from a company in country Y	1,50,000	
		2,00,000
Gross Total Income		**15,96,000**
Less: Deduction under Chapter VIA		
Under section 80QQB – Royalty income of a resident from literary work[3]		3,00,000
Total Income		**12,96,000**

Computation of tax liability of Mr. Kamesh for A.Y.2020-21

Particulars	₹
Tax on total income [30% of ₹ 2,96,000 + ₹ 1,12,500]	2,01,300
Add: Health and Education cess@4%	8,052
	2,09,352
Less: Deduction under section 91 **(See Working Note below)**	69,739
Tax Payable	**1,39,613**
Tax payable (rounded off)	1,39,610

Working Note: Calculation of Rebate under section 91

	₹	₹
Average rate of tax in India [i.e., ₹ 2,09,352 / ₹ 12,96,000 x 100]	**16.154%**	
Average rate of tax in country X	**10%**	
Doubly taxed income pertaining to country X		
Agricultural Income	50,000	

Royalty Income [₹ 6,00,000 – ₹ 50,000 (Expenses) – ₹3,00,000 (deduction under section 80QQB)][4]	2,50,000	
	3,00,000	
Deduction under section 91 on ₹ 3,00,000 @10% [being the lower of average Indian tax rate (16.154%) and foreign tax rate (10%)]		30,000
Average rate of tax in country Y	**20%**	
Doubly taxed income pertaining to country Y		
Income from house property	1,61,000	
Dividend	1,50,000	
	3,11,000	
Less: Business loss set-off	65,000	
	2,46,000	
Deduction u/s 91 on ₹ 2,46,000 @16.154% (being the lower of average Indian tax rate (16.154%) and foreign tax rate (20%)]		39,739
Total rebate under section 91 (Country X + Country Y)		**69,739**

Note: Mr. Kamesh shall be allowed deduction u/s 91, since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year (i.e., P.Y.2019-20).

(b) The income in question accrues or arises to him outside India in foreign countries X and Y during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign countries X and Y in his hands and it is presumed that he has paid tax on such income in those countries.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries X and Y where the income has accrued or arisen.

Section B – Additional Questions

Question 11

During the previous year 2019-20, Ms. Indu, a citizen of India is a resident of both India and a foreign country with which India has a DTAA, which provides that "the income would be taxable in country where it is earned and not in other country, but would be included for computation of tax rate in such other country". Her income is Rs. 3,25,000 from business in India and Rs. 6,00,000 from business in foreign country. In foreign country, the rate of tax is 20%. During the year, she paid a premium of Rs. 32,000 to insure the health of her mother, a non-resident, aged 82 years, not dependent on her, through her credit card.

(i) Compute the tax payable by Ms. Indu in India for the A.Y. 2020-21.

(ii) Also, show the tax payable by Ms. Indu in India, had there been no DTAA with such foreign country.

Answer

i. India has a DTAA with the Foreign Country

Computation of Tax Payable by Ms. Indu for A.Y. 2020-21

Particulars		Rs.
Income from business in India		3,25,000
Less: **Deduction under Chapter VI-A**		
- Deduction under section 80D in respect of medical premium for her mother to be restricted to		25,000
Total Income		3,00,000
Income from business in the foreign country		6,00,000
		9,00,000
Tax on Total Income	**Rs.**	
- Upto Rs. 2,50,000	Nil	
- 2,50,000 to Rs. 5,00,000 @ 5%	12,500	92,500
- 5,00,000 to Rs. 9,00,000 @ 20%	80,000	
Add: Education cess @4%		3,700
Tax Payable		**96,200**
Average tax rate in India (96,200 x 100/9,00,000)	10.689%	
Tax liability		
As per DTAA, the income earned in foreign country would not be taxable in India, but it has to be included in the total income only for computation of tax rate. Accordingly, Ms. Indu would only be liable to pay tax on income earned in India @ 10.689% and not on the foreign income.		
Indian Income included in total income = Rs. 3,25,000 – 25,000 = Rs. 3,00,000.		
Tax@10.689% of Rs. 3,00,000 (rounded off)		**32,070**

ii. India has no DTAA with the Foreign Country

Computation of Tax Payable by Ms. Indu for A.Y. 2020-21	Rs.
Tax on both Foreign and Indian Income (as computed in (1)(i) above)	96,200

Less: Relief under section 91 on foreign income of Rs. 6,00,000 @ 10.689% [lower of (average) Indian-tax rate (10.689%) or foreign tax rate (20%)] would be allowed	64,134
Tax Payable	**32,066**
Tax Payable (rounded off)	**36,070**

Question 12

Smt. Laxmi (age 70), a resident individual furnishes you the following particulars for the previous year 2019-20:

Particulars	Rs.
Income from business in India (computed)	6,00,000
Loss from let out property at Chennai	4,40,000
Dividend received from a domestic company	12,00,000
Business income in country "B" (tax paid thereon at 20%)	4,00,000
Rental income from property at Mumbai (computed)	1,80,000

Note: Assume that there is no double taxation avoidance agreement between India and country "B". Compute the total income and tax payable by Smt. Laxmi for the A.Y.2020-21.

Answer

Computation of total income and tax liability of Smt. Laxmi for A.Y. 2020-21

Particulars		Rs.	Rs.
Income from house property			
Rental income from property at Mumbai (computed)	1,80,000		
Less: Loss from let out property at Chennai	(4,40,000)	(2,60,000)	
Profits and gains from business and profession			
Business income in India	6,00,000		
Business income in Country B	4,00,000	10,00,000	
Less: Loss from house property of Rs. 2,60,000 allowed to be set-off to the extent of Rs. 2,00,000		(2,00,000)	8,00,000
Balance loss of Rs. 60,000 from house property to be carried forward to A.Y. 2021-22			
Income from other sources			
Dividend received from domestic company		12,00,000	
Less: Exempt under section 10(34)		10,00,000	2,00,000
Gross Total Income/ Total Income			**10,00,000**
Tax on total income			
Tax on Rs. 2,00,000 @10% under section 115BBDA			20,000
Tax on balance Rs. 8,00,000 [20% x Rs. 3,00,000 + Rs.10,000]			70,000
			90,000
Add: Education Cess @4%			3,600

		93,600
Average rate of tax in India[i.e., Rs.93,600 /Rs.10,00,000 x 100]	9.36%	
Average rate of tax in Country B	20%	
Doubly taxed income	4,00,000	
Rebate under section 91 on Rs. 4,00,000 @9.36% [lower of average Indian tax rate and rate of tax in Country B]		37,440
Tax payable in India [Rs. 92,700 – Rs. 37440]		**56,160**

Question 13

Amrutha is a resident Individual. She has income from the following sources:

(i) Taxable income from a sole-proprietary concern in Kochi ₹ 50 lakhs.

(ii) Share of profit from a partnership firm in Chennai ₹ 30 lakhs.

(iii) Agricultural Income from rubber estate in Country A which has no DTAA with India, USD 70000. Withholding Tax on the above income USD 10500 (Assume 1 USD = Rs 64).

(iv) Brought forward Business Loss in Country A was USD 10000 which is not permitted to be set off against other income as per the laws of that country.

Compute taxable income and tax payable by Amrutha for the A.Y. 2020-21.

Answer

Computation of taxable income and tax payable of Amrutha for A.Y. 2020 -21

Particulars	₹	₹
Profits and gains from business and profession		
Income from sole proprietary concern in India	50,00,000	
Share of profit from a partnership firm in India of ₹ 30 lakhs, is exempt	Nil	
Business profit	50,00,000	
Less: Business Loss in Country A (USD 10,000 x ₹64/USD)	6,40,000	
		43,60,000
Income from Other Sources		
Agricultural income from rubber estate in Country A, is taxable in India (USD 70,000 x ₹ 64/USD)		44,80,000
Gross Total Income/ Total Income		**88,40,000**
Tax on total income		
Tax on ₹ 88,40,000 [30% x ₹ 78,40,000 plus ₹1,12,500]		24,64,500
Add: Surcharge@10%, since total income exceeds ₹50 lakhs		2,46,450
		27,10,950
Add: Education cess @4%		1,08,438
		28,19,388
Average rate of tax in India [i.e., ₹ 28,19,388/₹88,40,000 x 100]	31.89%	
Average rate of tax in Country A [i.e., USD 10,500/USD 70,000]	15%	
Doubly taxed income [₹ 44,80,000 – ₹6,40,000]	38,40,000	
Rebate under section 91 on ₹ 38,40,000 @15% (lower of average Indian tax rate and rate of tax in Country A]		5,76,000

Tax payable in India [₹ 28,19,388 – ₹ 5,76,000]		**22,43,388**
Tax payable (rounded off)		**22,43,390**

Notes:

(1) Since Amrutha is resident in India for the P.Y.2019-20, her global income would be subject to tax in India. She would be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) She is a resident in India during the relevant previous year.

(b) Income accrues or arises to her outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in Country A in her hands and she has paid tax on such income in Country A.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country A, where the income has accrued orarisen.

Amrutha is eligible for deduction under section 91 since all the conditions specified thereunder stand fulfilled by her during the previous year.

(2) The above solution has been worked out assuming that the agricultural income of USD 70,000 is the gross amount.

Question 14

Mr. Manav, a resident, has derived certain income from a nation Q with which no DTAA exists. In Q, any income chargeable to tax is charged at a flat rate of 18%.

Mr. Manav has derived the following income from Q:

(i) Agricultural income from lands in Q ₹ 14 lakhs

(ii) Share income from a partnership firm in Q ₹ 18 lakhs

In nation Q, agricultural income is exempt and does not form part of total income.

State with reasons, whether, Mr. Manav (assessee) can claim double taxation relief in respect of the above two items of income and also determine the quantum of double taxation relief available.
The "Indian rate of tax" may be taken as 20%.

Answer

Mr. Manav is resident in India for the P.Y.2019-20, his global income would be subject to tax in India.

Agricultural income from lands located outside India would not be exempt from income-tax in India under section 10(1) in the hands of a resident. The said income would be chargeable to tax in his hands in India.

Share income from a partnership firm in County Q would not be exempt from income-tax in India under section 10(2A) in the hands of a partner. The same would be chargeable to tax in his hands in India.

Thus, both the above items of income are chargeable to tax in India in the hands of Mr. Manav.

The following are the conditions to be fulfilled for claiming benefit deduction under section 91:-

(i) Mr. Manav should be a resident in India during the relevant previous year.

(ii) The income accrues or arises to him outside India during that previous year.

(iii) Such income is not deemed to accrue or arise in India during the previous year.

(iv) Both the income given in question has been subjected to income-tax in Country Q in his hands and he has paid tax on such income in Country Q.

(v) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country Q, where the income has accrued or arisen.

Since all the conditions mentioned above are fulfilled, Mr. Manav is eligible for deduction under section 91 in respect of double taxed income i.e., share income from a firm in County Q.

However, he would not be eligible for deduction under section 91 in respect of agricultural income from lands in Country Q since such income is exempt in Country Q and consequently, is not a doubly taxed income.

Mr. Manav is entitled for deduction under section 91 of a sum calculated on share income from firm in Country Q at the Indian rate of tax (20%) or the rate of tax in Country Q (18%), whichever is lower.

Accordingly, deduction under section 91 available to Mr. Manav would be ₹ 3,24,000, being 18% of ₹18,00,000.

Note - It is logical to take a view that exemption under section 10(2A) in hands of the partner would be available only in respect of share income from an Indian firm. In this case, since the share income is from a foreign firm, the same is taxable in India in the hands of the partner. The above solution has been worked out on the basis of this view.

An alternate view that the share income from foreign firm is also exempt under section 10(2A) may also be possible, in which case, Mr. Manav would not be eligible for any deduction under section 91, since there would be no double taxed income.

Question 15

Mr. S is a performing musician, resident of India. He has the following income for the year ended 31-3-2020.

(1) Income from music performances in India ₹ 5,00,000.

(2) Income from Country A with which India does not have any Double Taxation Avoidance Agreement ₹ 5,00,000. Tax deducted from this income was at 20%.

(3) Income from Country B during January 2019 ₹ 1,00,000, July 2019 ₹ 1,00,000 and January 2020 ₹ 3,00,000.

Tax withheld by Country B is at 10%.

Country B follows Calendar Year for its tax purposes. India has entered into a Double Taxation Avoidance Agreement with Country B.

(4) Rent received from his property at Chennai ₹ 30,000 per month.

(5) Contribution to PPF is ₹ 1,50,000.

Compute tax payable by Mr. S for the Assessment Year 2020-21. Give necessary working notes for your answer.

Answer

Computation of total income of Mr. S for A.Y.2020-21

Particulars	₹	₹
Income from House Property in India		
Gross Annual Value [Rent received is taken as GAV] [₹ 30,000 p.m. x 12 months]	3,60,000	
Less: Municipal taxes	-	
Net Annual Value (NAV)	3,60,000	
Less: Deduction u/s 24 @30%	1,08,000	

Profits and Gains of Business or Profession		2,52,000
Income from music performances in India	5,00,000	
Income from Country A	5,00,000	
Income from Country B [Income earned during July 2019 and January 2020 is taxable in India in P.Y. 2019-20]	4,00,000	14,00,000
Gross Total Income		**16,52,000**
Less: Deduction under Chapter VIA		
Under section 80C – Contribution to PPF		1,50,000
Total Income		**15,02,000**

Computation of tax liability of Mr. S for A.Y.2020-21		
Particulars		**₹**
Tax on total income [₹1,50,600 (i.e., 30% of ₹ 5,02,000) plus ₹ 1,12,500 (Tax on income of ₹ 10 lakh)]		2,63,100
Add: Health and education cess @4%		10,524
Tax Liability		2,73,624
Average rate of tax in India [i.e., ₹ 2,73,624 / ₹ 15,02,000 x 100]	18.217%	
Foreign Tax credit		
For Country A (with which India does not have a DTAA)		
Doubly taxed income	5,00,000	
Deduction under section 91 on ₹ 5,00,000 @18.217% [being the lower of Indian rate of tax (18.217%) and Country A tax rate (20%)]		91,085
For Country B (with which India has a DTAA)		
Doubly taxed income [Credit shall be allowed for foreign tax paid by Mr. S in Country B in P.Y. 2019-20 in respect of income which is chargeable to tax in India in P.Y. 2019-20 i.e., for income of ₹ 4,00,000]	4,00,000	
Deduction under section 90:		
Lower of:		
Tax Payable under the Income-tax Act, 1961 i.e., ₹ 72,868, being 18.217% of ₹4,00,000; and		
Tax paid in Country B i.e., ₹ 40,000, being 10% of ₹ 4,00,000		40,000
Tax Payable		**1,42,539**
Tax Payable (Rounded off)		1,42,540

Question 16

Miss Sapna, a resident of India and a salaried employee employed with a private co., aged 30 years, received the following sums during the previous year 2019-20.

Basic Salary	₹ 45,000 p.m.
DA	10% of basic salary
Transport Allowance	₹ 8,000 p.m.
Medical Allowance	₹ 3,500 p.m.

She contributed ₹ 15,000 to approved Pension Fund of LIC. She also paid ₹ 1,75,000 by account

payee cheque for mediclaim premium to insure the health of her father, aged 65 years, who is not dependent on her as a lumpsum payment for 5 years including the current previous year.
Apart from this, she also provided guest lecture to a foreign university during the year. She received ₹ 7,92,000 from such university after deduction of tax of ₹ 1,08,000 in the country in which such university is located. India does not have any double taxation avoidance agreement under section 90 of the Income-tax Act, 1961, with that country. Compute the tax liability of Ms. Sapna for the A.Y. 2020-21.

Answer

Computation of total income of Miss Sapna for A.Y.2020-21

Particulars	₹	₹
Salaries [Indian Income]		
Basic Salary (₹ 45,000 x 12 months)	5,40,000	
Dearness Allowance (10% of basic salary of ₹ 5,40,000)	54,000	
Transport Allowance (₹ 8,000 x 12) [Fully taxable]	96,000	
Medical Allowance (₹ 3,500 x 12) [Fully taxable]	42,000	
Gross Salary	7,32,000	
Less: Standard deduction u/s 16 Lower of actual salary or ₹ 50,000	50,000	
Net Salary		**6,82,000**
Income from Other Sources [Foreign Income]		
Income from lectures in foreign university [₹ 7,92,000 plus tax deducted at source of ₹ 1,08,000]		9,00,000
Gross Total Income		**15,82,000**
Less: Deduction under Chapter VIA		
Under section 80CCC – Contribution to approved Pension Fund of LIC	15,000	
Under section 80D – Medical insurance premium of her father, being a resident senior citizen for the year 2019-20, ₹ 35,000 [being 1/5th of the lumpsum premium of ₹ 1,75,000 paid for 5 years] fully allowable, even though he is not dependent on her, since the same does not exceed ₹ 50,000	35,000	
		50,000
Total Income		**15,32,000**

Computation of tax liability of Miss. Sapna for A.Y.2020-21		
Particulars		**₹**
Tax on total income [₹ 1,59,600 (i.e., 30% of ₹ 5,32,000) plus ₹ 1,12,500 (Tax on income of ₹ 10 lakh)]		2,72,100
Add: Health and education cess @4%		10,884
Tax Liability		2,82,984
Average rate of tax in India [i.e., ₹ 2,82,984 / ₹ 15,32,000 x 100]	18.47%	
Tax rate in foreign country [1,08,000 /9,00,000] x 100	12%	
Deduction under section 91 on ₹ 9,00,000, being the doubly taxed income@ 12% [being the lower of Indian rate of tax (18.47%) and foreign tax rate (12%)]		1,08,000
Tax Payable		**1,74,984**
Tax Payable (rounded off)		1,74,980

CHAPTER - 4
Advance Rulings

Section A – ICAI Study Material Questions

Question 1

Examine whether a person resident in India can seek advance ruling from the Authority for Advance Ruling.

Answer

A resident can make an application to the Authority for Advance Ruling to seek an advance ruling in the following cases:

(i) Section 245N(b)(A)(III) enables a resident referred in section 245N(a)(iia) falling within any such class or category of persons as may be notified by the Central Government to make an application to Authority for Advance Rulings. Such notified resident applicant can seek ruling in relation to his tax liability arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application.

A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(ii) Section 245N(b)(A)(IV) enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek determination or decision by the AAR on a question of law or a question of fact relating to such computation of total income specified in the application.

"Public sector companies" as defined in section 2(36A) of the Income-tax Act, 1961 have been notified as applicant for this purpose.

(iii) A resident can also make an application seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.

(iv) A resident can make an application seeking advance ruling on whether an arrangement proposed to be undertaken by him is an impermissible avoidance arrangement under Chapter X-A.

Question 2

Q, a non-resident, made an application to the Authority for Advance Rulings on 2.7.2019 in relation to a transaction proposed to be undertaken by him. On 31.8.2019, he decides to withdraw the said application. Can he withdraw the application on 31.8.2019?

Answer

Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed since the date of application by Q to the Authority for Advance Rulings, he cannot withdraw the application.

However, the Authority for Advance Rulings (AAR), in M.K.Jain AAR No.644 of 2004, has observed that though section 245Q(3) provides that an application may be withdrawn by the applicant within 30 days from the date of the application, this, however, does not preclude the AAR from permitting withdrawal of the application after the said period, if the circumstances of the case so justify.

Question 3

Examine when can an advance ruling pronounced by the Authority for Advance Rulings be declared void. What is the consequence?

Answer

As per section 245T, an advance ruling can be declared to be void ab initio by the Authority for Advance Rulings if, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, it finds that the ruling has been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and Principal Commissioner or Commissioner.

Question 4

Mr. Balram is a non-resident. The appeal pertaining to the assessment year 2018-19 is pending before the Income-tax Appellate Tribunal, the issue involved being computation of export profit and tax thereon. The same issue persists for the assessment year 2019-20 as well. Mr. Balram's brother Mr. Krishna has obtained an advance ruling under Chapter XIX - B of Income-tax Act, 1961 from the Authority for Advance Rulings on an identical issue. Mr. Balram proposes to use the said ruling for his assessment pertaining to the assessment year 2019-20. Can he do so?

Answer

As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Rulings shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought. It shall also be binding on the Principal Commissioner/Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

In view of the above provision, Mr. Balram cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year 2019-20.

Note – Though the ruling of the Authority for Advance Rulings is not binding on others but there is no bar on the Tribunal taking a view or forming an opinion in consonance with the reasoning of the Authority for Advance Rulings dehors the binding nature.

Question 5

The Authority for Advance Rulings has the powers of compelling the production of books of account – Examine the correctness or otherwise of this statement.

Answer

The statement is correct.

Under section 245U, the Authority for Advance Rulings shall have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.

Accordingly, the AAR shall have the same powers as are vested in a court under the Code of Civil

Procedure, 1908, when trying a suit in respect of the following matters, namely -

(1) discovery and inspection;

(2) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

(3) compelling the production of books of account and other documents; and

(4) issuing commissions.

Therefore, the Authority for Advance Ruling has the powers of compelling the production of books of account.

Question 6

The term 'Advance Ruling' includes within its scope, a determination by the Authority for Advance Rulings only in relation to a transaction undertaken by a non-resident applicant. Examine the correctness of this statement, with reference to the provisions of the Income-tax Act 1961.

Answer

The statement is not correct.

The term 'Advance Ruling' has been defined in section 245N(a) to mean:-

(a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a **non-resident applicant**; or

(b) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken **by a resident applicant with such non-resident**; and such determination shall include the determination of any question of law or of fact specified in the application or

(c) a determination by the Authority in relation to the tax liability of a **resident applicant**, arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application

A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(d) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application.

(e) a determination or decision by the Authority whether an arrangement, which is proposed to be undertaken by **any person being a resident** or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

Question 7

An Irish company, Phi plc., entered into a contract with an Indian company, Beta Ltd., for provision of technical know-how and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Beta Ltd. Beta Ltd. had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the said payment to Phi plc. The Authority for Advance Rulings rejected the application of Phi plc. on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of Phi plc. justified in law?

Answer

This issue came up before the AAR in, Nuclear Power Corporation of India Ltd. In Re, [2012] 343 ITR 220, wherein it was held that an advance ruling is not only applicant specific, but is also transaction specific. The advance ruling is on a transaction entered into or undertaken by the applicant. That is why section 245S specifies that a ruling is binding on the applicant, **the transaction** and the Principal Commissioner or Commissioner of Income-tax and those subordinate to him, and not only on the applicant.

What is barred by the first proviso to section 245R(2) of the Act in the context of clause (i) thereof is the allowing of an application under section 245R(2) of the Act where "the question raised in the application is already pending before any Income-tax authority, or Appellate Tribunal or any court". The significance of the dropping of the words, "in the applicant's case" with effect from June 1, 2000, cannot be wholly ignored.

On the basis of this view expressed by the AAR in the above case, explaining the impact of the dropping of the words "in the applicant's case" with effect from 1.6.2000, a view can be taken that the AAR can reject the application made by Phi plc. before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know to Beta Ltd.

Note – The issue relates to the admission or rejection of the application filed before the Advance Rulings Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

The first proviso to section 245R(2) has been substituted by the Finance Act, 2000 with effect from 1.6.2000. Clause (i) of the first proviso, prior to and post amendment, reads as follows:

Prior to 1.6.2000	On or After 1.6.2000
Provided that the Authority shall not allow the application **except in the case of a resident applicant** where the question raised in the application is already pending **in the applicant's case** before any income-tax authority, the Appellate Tribunal or any court;	Provided that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.

The words "except in the case of a resident applicant" and "in the applicant's case" has been removed in clause (i) of the first proviso with effect from 1.6.2000. However, the Explanatory Memorandum to the Finance Act, 2000, explaining the impact of the substitution, reads as follows "It is proposed to substitute the proviso to provide that the Authority shall not allow the application when the question raised is already pending in the applicant's case before any income-tax authority, Appellate Tribunal or any court in regard to a non-resident applicant and resident applicant in relation to a transaction with a non-resident". Therefore, according to the intent expressed in the Explanatory Memorandum, the AAR shall not allow the application both in the case of resident and non-resident applicant if the question raised is already **pending in the applicant's case** before any income-tax authority. Thus, as per the Explanatory Memorandum, it is possible to take a view that even post-amendment, the Authority shall not allow the application only where a question is **pending in the applicant's case** before any income-tax authority. Thus, an alternative view is possible on the basis of the AAR ruling in Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203, which continues to hold good even after the amendment, if we consider the intent expressed in the Explanatory Memorandum. **Accordingly, based on this view, the AAR can allow the application made by Phi plc., even if the question raised in the application is pending before the Assessing Officer in Beta Ltd.'s case**.

CHAPTER - 5
Equalisation Levy

Section A – ICAI Study Material Questions

Question 1

Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions.

Answer

The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the Income-tax Act, 1961 are absence of national boundaries, no requirement of physical presence of goods and no requirement of physical delivery (in certain cases). Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.

Question 2

E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the issues involving such transactions.

Answer

The typical taxation issues relating to e-commerce are:

(1) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,

(2) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

Question 3

ABC ltd., an Indian company, is carrying on the business of manufacture and sale of teakwood furniture under the brand name "PUREWOOD". In order to expand its overseas sales/exports, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of PQR Inc., a London based company. During the previous year 2019-20, ABC Ltd. Paid ₹ 5 lakhs to PQR Inc. for such services. Discuss the tax implications/TDS implications of such payment and receipt in the hands of ABC Ltd. and PQR Inc., respectively, if –

(i) PQR Inc. has no permanent establishment in India

(ii) PQR Inc. has a permanent establishment in India, and the service is effectively connected to the permanent establishment in India

Answer

Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

"Specified Service" means

(1) online advertisement;

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and

(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India and the specified service is effectively connected with such permanent establishment.
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed ₹ 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

(i) Where PQR Inc. has no permanent establishment in India

In the present case, equalisation levy @6% is chargeable on the amount of ₹ 5,00,000 received by PQR Inc., a non-resident not having a PE in India from ABC Ltd., an Indian company. Accordingly, ABC Ltd. is required to deduct equalisation levy of ₹ 30,000 i.e., @6% of ₹ 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

(ii) Where PQR Inc. has permanent establishment in India and the service is effectively connected to the permanent establishment in India

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India and the service is effectively connected to the permanent establishment in India. Therefore, the ABC Ltd. is not required to deduct equalisation levy on ₹5 lakhs, being the amount paid towards online advertisement services to PQR Inc, in this case.

However, tax has to be deducted by ABC Ltd. at the rates in force under section 195 in respect of such payment to PQR Inc. Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income.

Section B – Additional Questions

Question 4

M/s. Raghuram Co. Ltd., Mumbai entered into the following agreements with various non- resident entities during the previous year 2019-20:

(i) Paid ₹ 4,00,000 to M/s. Neil Inc., a company based in USA for online advertisement of its products. M/s. Neil Inc., does not have a PE in India.

(ii) Paid ₹ 50,000 to Mr. David, a non-resident individual, against providing digital space for online advertisement of its products.

(iii) Paid ₹ 1,55,000 to M/s LOX Ltd., for providing a platform for sale of its used furniture items. M/s. LOX Ltd., is a company based in New Zealand and does not have a PE in India.

Discuss the relevant provisions of Income-tax Act, in respect of such agreements and also state the tax implications of such payments.

Answer

Chapter VIII of the Finance Act, 2016, provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment (PE) in India, from a resident in India who carries out business or profession, or from a non-resident having PE in India.

"Specified services" means -

(i) Online advertisement;

(ii) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;

(iii) Any other service as may be notified by the Central Government.

However, equalization levy is not chargeable where the aggregate amount of consideration for specified service received or receivable in a previous year by the non- resident from a person resident in India and carrying on business or profession, or from a non-resident having a PE in India, does not exceed ₹ 1 lakh.

Further, equalization levy is not attracted where payment for specified service is not for the purposes of carrying out business or profession.

(i) In this case, equalisation levy @6% is chargeable on the amount of ₹ 4,00,000 received by M/s Neil Inc., a non-resident not having a PE in India, from M/s Raghuram Co. Ltd., an Indian company for online advertisement of its products. Accordingly, M/s Raghuram Co. Ltd. is required to deduct equalisation levy of ₹ 24,000 i.e., @6% of ₹ 4 lakhs, being the amount paid towards online advertisement services provided by M/s Neil Inc.

Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid to M/s. Neil Inc. while computing business income of M/s. Raghuram Co. Ltd.

(ii) In this case, equalisation levy is **not** chargeable as the amount of consideration of ₹ 50,000 for digital space for online advertisement paid to Mr. David does not exceed ₹1,00,000.

(iii) In this case, equalisation levy is **not** chargeable on the amount of ₹ 1,55,000 received by M/s LOX Ltd., a non-resident not having a PE in India, from M/s Raghuram Co. Ltd., an Indian company, since the said payment was for providing a platform for sale of its used furniture items and not for the purposes of carrying on business or profession.

Question 5

Raghu Ltd made a payment of ₹ 3,00,000 on 30-6-2019 towards procuring online advertisement space to a foreign company which had no place of business in India. The company remitted the equalization levy on 23-3-2020. Calculate interest and penalty payable by Raghu Ltd. if any.

Answer

Interest for failure to remit the equalization levy

An assessee who fails to credit the equalisation levy or any part thereof within 7th of the month following the calendar month in which it is deducted, to the account of the Central Government, has to pay simple interest at the rate of 1% of such levy for every month or part of a month by which such crediting of the tax or any part thereof is delayed.

In the present case, Raghu Ltd. is required to remit the equalization levy of ₹ 18,000 i.e., 6% of ₹ 3,00,000 by 07.7.2019. However, since it remitted the said levy only on 23.3.2020, the interest ₹ 1,620 i.e., @1% would be levied for 9 months.

Penalty for failure to pay equalisation levy

Failure to remit equalisation levy to the Central Government on or before 7th of the following month, after deduction would attract a penalty of ₹ 1,000 for every day during which the failure continues. However, such penalty shall not exceed the amount of equalisation levy that he failed to pay.

Thus, in the present case, penalty of ₹ 2,59,000 (₹ 1000 x 259) would be limited to ₹ 18,000, being the amount of equalization levy which the assessee has failed to pay.

CHAPTER - 6
Application & Interpretation of Tax Treaties

Section A – ICAI Study Material Questions

Question 1

What do you mean by double taxation? Discuss the connecting factors which lead to double taxation.

Answer

The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business **with that country** or **in that country**. Internationally, the term used to determine the jurisdiction for taxation is "connecting factors". There are two types of connecting factors, namely, "Residence" and "Source". It means a company can be subject to tax either on its residence link or its source link with a country. Broadly, if a company is doing business **with** another country (i.e. host/source country), then it would be subject to tax in its home country alone, based on its residence link. However, if a company is doing business **in a** host/source country, then, besides being taxed in the home country on the basis of its residence link, it will also be taxed in the host country on the basis of its source link.

- **Juridical double taxation:** When source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as "juridical double taxation".

  In order to avoid such double taxation, a company can invoke provisions of Double Taxation Avoidance Agreements (DTAAs) (also known as **Tax Treaty** or Double Taxation Convention– DTC) with the host/source country, or in the absence of such an agreement, an Indian company can invoke provisions of section 91, providing unilateral relief in the event of double taxation.

- **Economic double taxation:** 'Economic double taxation' happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different persons (because of lack of subject identity)

Question 2

"In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into tax treaty". Elucidate.

Answer

In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into a tax treaty, as mentioned below:

- Ensuring non-discrimination between residents and non-residents
- Resolution of disputes arising on account of different interpretation of tax treaty by the treaty partner.
- Providing assistance in the collection of the fair and legitimate share of tax.

Further, in addition to above, there are some other principles which must be considered by countries in their tax system –

(i) **Equity and fairness:** Same income earned by different taxpayers must be taxed at the same rate regardless of the source of income.

(ii) **Neutrality and efficiency:** Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.

(a) Capital export neutrality and

(b) Capital import neutrality (CIN).

Capital export neutrality (CEN) provides that business decision must not be affected by tax factors between the country of residence and the target country; whereas CIN provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) **Promotion of mutual economic relation, trade and investment:** In some cases, it is observed that avoidance of double taxation is not the only objective. The other objective may be to give impetus to a country's overall economic growth and development.

Question 3

What is the General Rule of Interpretation under Vienna Convention of Law of Treaties?

Answer

Article 31 of Vienna Convention of Law of Treaties contains the General Rule of Interpretation. It lays down that following general rule of interpretation:

- A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose.
- The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure
  - (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
  - (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto.
- The following shall be taken into account, together with the context in that:
  - (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  - (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
  - (c) Any relevant rules of international law applicable to relation between the parties.
- A special meaning shall be given to a term if it is established that the parties so intended.

Question 4

What are the Extrinsic Aids to interpretation of a tax treaty?

Answer

A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention, the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke, one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:

(i) Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;

(ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];

(iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;

(iv) Other treaties, in pari materia (i.e., relating to the same subject matter), in case of doubt.

Provisions in Parallel Tax Treaties

If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y?

However, the views of the Indian Judiciary are not consistent in this respect. There are contradictory judgments by Indian courts/tribunal in this regard.

International Articles/Essays/Reports

International Article/Essays/Reports are referred as extrinsic aid for interpretation of tax treaties. Like, in case of CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP), the High Court obtained "useful material" through international articles.

Cahiers published by International Fiscal Association (IFA), Netherlands

"Cahiers de Droit Fiscal International" is the main publication of the IFA, which is published annually and deals with two major topics each year. Cahiers were relied upon in case of Azadi Bachao Andolan's (supra) case by the Supreme Court.

Protocol

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.

Protocol to India France treaty contains the Most Favoured Nation Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

Preamble

Preamble to a tax treaty could guide in interpretation of a tax treaty. In case of Azadi Bachao Andolan, the Apex Court observed that 'the preamble to the Indo-Mauritius Double Tax Avoidance Treaty recites that it is for the 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty'. These observations are very significant whereby the Apex Court has upheld 'economic considerations' as one of the objectives of a Tax Treaty.

Mutual Agreement Procedure [MAP]

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.

Section B – Additional Questions

Question 5

Explain the meaning of "Treaty" as per Article 2 of Vienna Convention on Law of Treaties, 1969. Why it come into play?

Answer

Article 2 of Vienna Convention on Law of Treaties, 1969 defines "treaty" as an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation

Treaties (Double Tax Avoidance Agreements) come into play to mitigate hardship caused by subjecting the same income to double taxation.

Tax Treaties attempt to eliminate double taxation and try to achieve balance and equity. They aim at sharing of tax revenues by the concerned States on a rational basis.

Question 6

Explain the following terms in the context of interpretation of tax treaties:

(a) Principle of Contemporanea Expositio

(b) Teleological Interpretation

Answer

(a) Principle of Contmporanea Expositio

A treaty's terms are normally to be interpreted on the basis of their meaning at the time the treaty was concluded. However, this is not a universal principle.

In Abdul Razak A. Meman's (2005) 276 ITR 306, the AAR observed that "there can be little doubt that while interpreting treaties, regard should be had to material contemporanea expositio. This proposition is embodied in article 32 of the Vienna Convention and is also referred to in the decision of Supreme Court in K. P. Varghese v. ITO [1981] 131 ITR 597.

(b) Teleological Interpretation

In this approach the treaty is to be interpreted so as to facilitate the attainment of the aims and objectives of the treaty. This approach is also known as 'objects and purpose' method.

In case of Union of India v. Azadi Bachao Andolan 263 ITR 706, the Supreme Court observed that "the principles adopted for interpretation of treaties are not the same as those in interpretation of statutory legislation. The interpretation of provisions of an international treaty, including one for double taxation relief, is that the treaties are entered into at a political level and have several considerations as their bases."

One instance is where the Apex Court agreed with contention of Appellant that "the preamble to the Indo-Mauritius DTAA recites that it is for 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty.

Question 7

Examine and state the correctness or otherwise of each of the following statements in the context of international tax treaties between the countries and answer in brief with reasons thereof:

(i) "Providing assistance in the collection of the fair and legitimate share of tax by the countries involved" is the sole objective of Tax Treaties entered among Countries.

(ii) A Protocol is an integral part of the Tax Treaty and has the same binding force as the main clauses therein.

Answer

(i) The statement is **not correct.**

The objectives of tax treaties also include

- allocating tax rights,
- elimination of double taxation,
- ensuring non-discrimination between residents and non-residents and
- resolution of disputes of on account of different treaty interpretation.

(ii) The statement is **correct.**

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

Question 8

(i) Briefly Jurisdictional double taxation and Economic double taxation. How does the tax law provide for remedial measures?

(ii) Do you agree that the tax treaties are to be interpreted liberally? If so, why?

Answer

(i) **Jurisdictional double taxation and economic double taxation**

When source rules overlap, double taxation may arise i.e., tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as "jurisdictional double taxation".

This can also be explained with the help of an example. A particular income is taxed in the hands of a person in the country in which it arises (Source State) and also in the country in which such person is a resident (Residence State), by virtue of the domestic tax laws of the respective Contracting States. This gives rise to jurisdictional double taxation.

'Economic double taxation' happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different persons.

For example, in India, income of a firm is subject to tax and partner's share in the income of the firm is exempt. However, if partner is a resident of another country, where share income from firm is taxable, economic double taxation would arise.

In order to avoid jurisdictional double taxation, relief available under the provisions of Double Taxation Avoidance Agreements (DTAAs) with the source country can be utilized, or in the absence of such an agreement, provisions of section 91, providing unilateral relief in the event of double taxation, would be applicable.

Tax treaties generally do not cover instances of economic double taxation. Mutual Agreement Procedure (MAP) provides relief in cases of economic double taxation.

(ii) Yes, I agree with the given statement.

It is a general principle of construction with respect to treaties that they shall be liberally construed so as to carry out the apparent intention of the parties.

Contrary to an ordinary taxing statute, a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated in so far as the particular item under consideration is concerned.

CHAPTER - 7
Fundamentals of BEPS

Section A – ICAI Study Material Questions

Question 1

What do you understand by base erosion and profit shifting? Describe briefly its adverse effects.

Answer

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.

Adverse Effects of BEPS:

(1) Governments have to cope with less revenue and a higher cost to ensure compliance.

(2) In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth.

(3) BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. When tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden.

(4) Enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Question 2

What are the significant OECD Recommendations under Action Plan 1 of BEPS? Which recommendation has been adopted in Indian tax laws?

Answer

The OECD has recommended several options to tackle the direct tax challenges which include:

(1) Modifying the existing Permanent Establishment (PE) rule to provide that whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

(2) A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.

(3) Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of

business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

In order to address these challenges, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

Meaning of "Specified Service":

(1) Online advertisement;
(2) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;

Specified Service also includes any other service as may be notified by the Central Government.

Further, in order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India or from a non-resident having a permanent establishment in India does not exceed ₹ 1 lakh in any previous year.

Note: The Finance Act, 2018 has amended section 9(1)(i) to provide that significant economic presence would also constitute business connection from A.Y.2019-20. However, Rules in this regard are yet to be notified

Question 3

Discuss the provision incorporated in the Income-tax Act, 1961 in line with the OECD recommendations under Action Plan 4 of BEPS.

Answer

In line with the recommendations of OECD BEPS Action Plan 4, section 94B has been inserted in the Income-tax Act, 1961 by the Finance Act, 2017 to provide a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible.

The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

In order to target only large interest payments, it provides for a threshold of interest expenditure of ₹ 1 crore in respect of any debt issued by a non-resident associated enterprise exceeding which the provision would be applicable. Banks and Insurance business are excluded from the ambit of the said provisions keeping in view of special nature of these businesses.

Question 4

Describe the three tier structure for transfer pricing documentation mandated by BEPS Action Plan 13.

Answer

Action 13 contains a three-tiered standardized approach to transfer pricing documentation which consists of:

(a) **Master file**: Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.

(b) **Local file**: Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.

(c) **Country-by-country (CBC) report**: CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

Question 5

Explain the nexus approach recommended by OECD in BEPS Action Plan 5 which has been adopted in the Income-tax Act, 1961.

Answer

In India, the Finance Act, 2016 has introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, section 115BBF has been inserted in the Income-tax Act, 1961 to provide that where the total income of the eligible assessee (being a person resident in India who is the true and first inventor of the invention and whose name is entered in the patent register as the patentee in accordance with the Patents Act, 1970 and includes every such person, being the true and the first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent.) includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

Question 6

What are the ways in which hybrid mismatch arrangements are used to achieve unintended double non-taxation or long-term tax deferral?

Answer

Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -

(1) Creation of two deductions for a single borrowal;

(2) Generation of deductions without corresponding income inclusions;

(3) Misuse of foreign tax credit; and

(4) Participation exemption regimes.

Section B – Additional Questions

Question 7

What is meant by Thin Capitalisation? Why is it considered as an anti avoidance measure? Which action plan of BEPS addresses Thin Capitalisation? Explain the provision incorporated in the Income-tax Act, 1961 to address Thin Capitalisation.

Answer

A company is typically financed or capitalized through a mixture of debt and equity. The manner in which company raises capital has a significant impact on the amount of profit it reports for tax purposes. This is due to the reason that tax legislations of countries typically allow a deduction for interest paid or payable in arriving at the profit for tax purposes while the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus, the amount of interest it pays, the lower will be its taxable profit. For this reason, debt is often a more tax efficient method of finance than equity. Since in such a structure, equity financing is less, it is referred to as Thin Capitalization. Thin capitalization, thus, refers to the process of funding an entity by debt instead of equity with a view to take advantage of interest deduction benefits.

Multinational groups are often able to structure their financing arrangements to maximize these benefits. To prevent tax erosion on account of such arrangements, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base. Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in its Action Plan 4. The OECD has recommended several measures in its final report to address this issue. In view of the above, new section 94B has been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest paid or payable by an entity to its non-resident associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to non-resident associated enterprises, whichever is less.

Question 8

Which action plan of BEPS requires introduction of Limitation of Benefits clause in a tax treaty? Has India introduced Limitation of Benefits clause in its tax treaties in line with the BEPS Action Plan? Discuss.

Answer

BEPS Action Plan 6 – Preventing Treaty Abuse requires introduction of Limitation of Benefits (LOB) clause or Principal Purpose Test (PPT) rule or both to protect against treaty shopping. Treaty shopping is a practice by which a resident of a third country takes advantage of beneficial treaty provisions between two countries by establishing a shell or conduit company in one of the two countries, where tax incidence is low.

Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping (the minimum standard). That commitment will require countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

Accordingly, on 10th May, 2016, India and Mauritius has signed a protocol amending the India-Mauritius tax treaty at Mauritius. In the said treaty, for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. The tax rate on such capital gains arising during the period from 1.4.2017-31.3.2019 should, however, not exceed 50% of the tax rate applicable on such capital gains in India. A Limitation of Benefit (LOB) Clause has been introduced which provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. Further, a shell or a conduit company claiming to be a resident of a Contracting State shall not be entitled to this benefit. A shell or conduit company has been defined as any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.

CHAPTER - 8
Overview of Model Tax Conventions

Section A – ICAI Study Material Questions

Question 1

Explain briefly the significant difference between the UN and OECD Model Tax Convention.

Answer

OECD Model is essentially a model treaty between two developed nations whereas UN Model is a model convention between a developed country and a developing country.

Further, OECD Model advocates the residence principle, i.e., it lays emphasis on the right of state of residence to tax the income, whereas the UN Model is a compromise between the source principle and residence principle, giving more weight to the source principle as against the residence principle.

Question 2

When does it become necessary to apply the tie-breaker rule? Discuss the manner of application of the tie-breaker rule.

Answer

Every jurisdiction, in its domestic tax law, prescribes the mechanism to determine residential status of a person. If a person is considered to be resident of both the Contracting States, relief should be sought from Article 4 of the Tax Treaty. A series of tie-breaker rules are provided in Paragraph 2 Article 4 of Model Convention to determine single state of residence for an individual.

The tie-breaker rule would be applied in the following manner:

(i) The first test is based on where the individual has a **permanent home**. Permanent home would mean a dwelling place available to him at all times continuously and not occasionally and includes place taken on rent for a prolonged period of time.

(ii) If that test is inconclusive for the reason that the individual has permanent home available to him in both Contracting States, he will be considered a resident of the Contracting State where his personal and economic relations are closer, in other words, the place where lies **his centre of vital interests**. Thus, preference is given to family and social relations, occupation, place of business, place of administration of his properties, political, cultural and other activities of the individual.

(iii) Paragraph (ii) establishes a secondary criterion for two quite distinct and different situations:

- The case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests;
- The case where the individual has a permanent home available to him in neither Contracting State.

In the aforesaid scenarios, preference is given to the Contracting State where the individual has an **habitual abode**.

(iv) If the individual has habitual abode in both Contracting States or in neither of them, he shall

be treated as a resident of the Contracting State of which he is **a national**.

(v) If the individual is a national of both or neither of the Contracting States, the matter is left to be **considered by the competent authorities** of the respective Contracting States.

Question 3

Explain the meaning of "interest" and "fees for technical services" under the UN Model Convention.

Answer

As per Article 11 of the UN Model Convention, "Interest" essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

As per Article 12A of the UN Model Convention, "Fees for technical services" is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use.

Section B – Additional Questions

Question 4

What is the difference between OECD Model Convention, 2017 and UN Model Convention, 2017 relating to right of Source State to tax business profits of an enterprise? Explain.

Answer

Business profits of an enterprise can only be taxed by the Residence State. Right of Source State to tax business profits of an enterprise only arises if it carries on business through a Permanent Establishment (PE) situated in that State.

As per the approach under the OECD Model Convention, once a PE is proven, the Source State can tax only such profits as are attributable to the PE. The UN Model Convention amplifies this attribution principle by a **limited** Force of Attraction rule (FOA).

The FOA rule implies that when a foreign enterprise sets up a PE in State of Source, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that profits that the enterprise derives from Source State of Source, whether through the PE or not, can be taxed by it (State of Source State).

As per Article 7 of the UN Model Convention, if the enterprise carries on business in the other Contracting State through a PE, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:

(a) that PE;

(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that PE; or

(c) other business activities carried on in that other State of the same or similar kind as those effected through that PE.

Question 5

What are the differences between the OECD Model Convention and UN Model Convention in relation to the article on Permanent Establishment? Examine.

Answer

In relation to Article 5 on Permanent Establishment, the UN Model Convention varies from the OECD Model Convention in the following aspects:

(i) As per Article 5(3)(a) of the OECD Model Convention, a building site or construction or installation project constitutes a PE if it lasts more than twelve months. The UN Model Convention is wider as it covers "assembly and installation project" and "supervisory" activities in connection thereto and requires the activity in question to continue only for six months for constituting a PE.

(ii) Article 5(3)(b) of the UN Model Convention makes a specific reference to Service PE which is absent in the OECD Model Convention. Under the UN Model Convention, furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose would constitute a PE, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12 month period commencing or ending in the fiscal year concerned.

In the absence of a Service PE reference in OECD Model Convention, the presence has to be ascertained through general principles under Article 5(1).

(iii) The UN Model Convention has an additional Article 5(6) relating to insurance which is absent

in OECD Model Convention. As per this Article in the UN Model Convention, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.

In the absence of similar Article in the OECD Model Convention, a PE of an insurance Enterprise has to be determined in accordance with provisions of Article 5(1) or 5(2) of the OECD Model Convention.